CLERK'S COPY

TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1937

No. 528

PACIFIC NATIONAL COMPANY, PETITIONER,

vs.

GALEN H. WELCH, FORMER COLLECTOR OF INTERNAL REVENUE FOR THE SIXTH DISTRICT OF CALIFORNIA

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

PETITION FOR CERTIORARI FILED OCTOBER 25, 1937.

CERTIORARI GRANTED DECEMBER 6, 1937.

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original record are printed literally in italics; and, likewise, cancelled matter appearing in the original record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italics the two words between which the omission seems to occur.]

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Names and Addresses of Attorneys.

For Appellant:

MELVIN D. WILSON, Esq.,
433 South Spring Street,
Los Angeles, California.

For Appellee:

PEIRSON M. HALL, Esq.,
United States Attorney,
Federal Building,

EUGENE HARPOLE,
Assistant United States Attorney,
939 South Broadway,
Los Angeles, California.

United States of America, ss:

To GALEN H. WELCH, Former Collector of Internal Revenue for the Sixth District of California, and PEIRSON M. HALL, United States Attorney,— GREETING:

You are hereby cited and admonished to be and appear at a United States Circuit Court of Appeals for the Ninth Circuit, to be held at the City of San Francisco, in the State of California, on the 23rd day of June, A. D. 1935, pursuant to Order Allowing Appeal filed in the Clerk's Office of the District Court of the United States, in and for the Southern District of California, in that certain cause entitled "PACIFIC NATIONAL COMPANY, a corporation, v. GALEN H. WELCH, Former Collector of Internal Revenue for the Sixth District of California," No. 5827-M, wherein PACIFIC NATIONAL COMPANY, a corporation, is the Plaintiff and Appellant, and you are Defendant and Appellee, to show cause, if any there be, why the Judgment and Decree heretofore entered on April 5, 1935, in the said Order Allowing Appeal mentioned, should not be corrected, and speedy justice should not be done to the parties in that behalf.

WITNESS, the Honorable PAUL J. McCORMICK, United States District Judge for the Southern District of California, this 23rd day of May, A. D. 1935, and of the Independence of the United States, the one hundred and fifty-ninth.

Paul J. McCormick

U. S. District Judge for the Southern District of California.

[TITLE OF COURT AND CAUSE.]

AFFIDAVIT OF SERVICE OF CITATION.

STATE OF CALIFORNIA)
) ss.
County of Los Angeles)

Wilbur G. Smith, being sworn, says: That I am and was on the dates herein mentioned over the age of eighteen years and not a party to this action; I served the CITATION in this action by personally delivering to and leaving with the following person, at the County of Los Angeles, on the date set opposite his name a true copy thereof, to-wit:

Peirson M. Hall, United States Attorney, by delivering to Hugh Dickson, Asst. U. S. Atty., Federal Bldg., Los Angeles, Calif on May 24, 1935 Counsel for defendant and appellee.

Wilbur G. Smith

Subscribed and sworn to before me this 24th day of May, 1935.

[Seal] Mildred K. Rogers
Notary Public in and for the County of Los Angeles, State of California.

[Endorsed]: Filed May 24, 1935 R. S. Zimmerman Clerk By L. Wayne Thomas, Deputy Clerk

IN THE UNITED STATES DISTRICT COURT IN AND FOR THE SOUTHERN DISTRICT OF CALIFORNIA CENTRAL DIVISION

PACIFIC NATIONAL COM-, PANY, a corporation,	
Plaintiff,	At Law No. 5827-M
vs.	AMENDED COMPLAINT TO RECOVER FEDERAL CORPORATE INCOME TAXES.
GALEN H. WELCH, Former Collector of Internal Revenue for the Sixth District of California,	
Defendant.	

After permission of the Court having first been obtained, Plaintiff files its Amended Complaint, and as a cause of action against the Defendant alleges:

I.

That the jurisdiction of this Court is dependent upon a Federal question in that the cause arises under the laws of the United States pertaining to Internal Revenue, to-wit: The Revenue Act of 1928.

II.

Plaintiff herein is, and during all the times hereinafter mentioned was, a corporation organized under the laws of the State of California, and has its principal office and place of business in the Pacific National Bank Building, 315 West Ninth Street, Los Angeles, California.

III.

That the Defendant, Galen H. Welch, was, from April 6, 1926 to June 30, 1933, the duly commissioned and acting Collector of Internal Revenue for the Sixth Collection District of California, pursuant to the laws of the United States, and during all the times hereinafter mentioned, resided, and still resides and has his office in the City of Los Angeles, County of Los Angeles, State of California.

IV.

That this action is brought against the Defendant as a former officer acting under and by virtue of the Revenue Act of 1928, in effect for the year 1928, on account of acts done under color of his office and of the Revenue laws of the United States, as will hereinafter more fully appear.

V.

That Plaintiff filed with the proper officer designated by Statute, its corporation income tax return for the calendar year 1928, as required by law, within the statutory period, to-wit: On or about the 14th day of March, 1929, and paid a tax to the Defendant of $10,761.28, as follows:

March 14, 1929—	$ 2,690.30
June 12, 1929—	2,690.30
September 11, 1929—	2,690.34
December 12, 1929—	2,690.34
Total—	$10,761.28

VI.

That thereafter, to-wit: On the 26th day of February, 1931, Plaintiff, in the time and manner provided by law and regulations for filing claims for refund, filed with the Defendant and with the Commissioner of Internal Revenue, its claim for the refund of said tax amounting to $10,761.28, a copy of which Claim is attached hereto and marked Exhibit "A".

VII.

That on or about the 17th day of May, 1932, the Commissioner of Internal Revenue rejected that portion of Plaintiff's Claim for Refund which pertained to the grounds set forth in this cause of action. The Commissioner allowed Plaintiff's Claim for Refund in the amount of $1,091.39, together with interest thereon, based on other grounds not material to this suit.

VIII.

During the year 1928, the Plaintiff was the sole beneficiary of Trust No. P. T. 46, Pacific National Bank, Trustee. This Trust was a subdivision Trust engaged in subdividing and improving a parcel of property and selling lots therefrom.

IX.

Trust No. P. T. 46, Pacific National Bank, Trustee, kept its books on the cash basis, except that gross profits from the sale of lots were computed on the installment basis, that is, on the basis of collections. On such basis the Trust had a loss, for 1928. The Pacific National Bank, Trustee of Trust No. P. T. 46, throughout 1928, did not file an income tax return covering the activities of the Trust for 1928.

X.

In its return for 1928 the Plaintiff erroneously reported the amount of $137,007.17 as being the income for 1928 of Trust No. P. T. 46, Pacific National Bank, Trustee.

XI.

That Plaintiff should not have reported anything in its 1928 return as income of Trust No. P. T. 46, Pacific National Bank, Trustee, on the basis on which the Trustee kept the accounts of the Trust.

XII.

That the Plaintiff, for the year 1928, had a net loss, before taking into consideration the loss of Trust No. P. T. 46, Pacific National Bank, Trustee, of $32,425.47.

XIII.

That if the loss of Trust No. P. T. 46, Pacific National Bank, Trustee, is reflected in Plaintiff's 1928 return, Plaintiff would still have a loss and would not be liable for any income tax for the year 1928, and is entitled to a refund and judgment for the tax erroneously paid, amounting to $9,669.89.

XIV.

Subsequent to March 15, 1929, the Bank of America National Trust & Savings Association succeeded the Pacific National Bank as Trustee of Trust No. P. T. 46. As successor Trustee, the Bank of America National Trust & Savings Association filed, with the Collector of Internal Revenue for the sixth Collection District of California, a Fiduciary return for the year 1928, for the said Trust, on the installment basis.

XV.

That the Defendant erroneously and unlawfully collected and is erroneously and unlawfully withholding in-

come tax for the year 1928, in the amount of $9,669.89, from the Plaintiff, and is indebted to the Plaintiff in the sum of $9,669.89, plus interest at 6 per cent per annum from March 14, 1929, on $2,690.30; and from June 12, 1929, on $2,690.30; and from September 11, 1929, on $2,690.34; and from December 12, 1929, on $1,598.95; and although often demanded the Defendant has not, nor has anyone for him, repaid or refunded said sum, or any part thereof; and that said claim for refund is the sole property of Plaintiff herein, and has not been sold, transferred, or assigned to any corporation, firm or individual.

FOR A FURTHER AND SECOND CAUSE OF ACTION AGAINST DEFENDANT, PLAINTIFF ALLEGES AS FOLLOWS:

I.

Plaintiff hereby refers to paragraphs I, II, III, IV, V, VI, VII, VIII, IX, X, XII, XV of its first cause of action and by reference incorporates the same herein as though fully set out herein.

II.

That on June 11, 1931, Plaintiff, in the time and manner provided by law and regulations for filing claims for refund, filed with the Defendant and with the Commissioner of Internal Revenue, its Amended Claim for the refund of said tax amounting to $10,761.28. This Amended Claim was based on the proposition that Trust No. P. T. 46, Pacific National Bank, Trustee, was, during 1928, an association taxable as a corporation; that while it was a member of a consolidated group of corporations, the other corporations in the group, namely, Plaintiff and Pacific National Building Corporation, had

filed separate corporation income tax returns for 1928; that the association, Trust No. P. T. 46, should have filed a separate corporation income tax return; that it could not file a consolidated return with Plaintiff.

III.

That the Commissioner of Internal Revenue, in his Revenue Agent's Report dated June 16, 1931, considered the grounds set out in the Amended Claim referred to in the preceding paragraph.

IV.

Plaintiff, on July 27, 1931, and on September 11, 1931, supplemented its said Amended Claim for Refund.

V.

On August 25, 1931, Plaintiff's Amended Claim for Refund was considered in a conference between Plaintiff's Accountants and Conferees in the office of the Internal Revenue Agent in Charge, Los Angeles, California. The Conferees, on September 23, 1931, in a letter to Plaintiff, ruled that Trust No. P. T. 46 was not an association, and advised that the file would be forwarded to the Commissioner of Internal Revenue in Washington, D. C.

VI.

After some further correspondence between Plaintiff and the Commissioner of Internal Revenue at Washington, D. C., the Commissioner, on February 15, 1932, in a letter addressed to Plaintiff, ruled that Trust No. P. T. 46, was not an association, and therefore Plaintiff's claim would be denied for $9,669.89, and allowed for $1,091.39 on other points not material to this suit.

VII.

On April 1, 1932, Plaintiff's Attorneys had a conference with the Commissioner of Internal Revenue in Washington, D. C., on this Amended Claim for Refund.

VIII.

While the audit of the Amended Claim for Refund was still pending, Plaintiff, on April 4, 1932, filed its Amended Claim for Refund, a copy of which is attached hereto and marked Exhibit "B".

IX.

Trust No. P. T. 46 was an association taxable as a corporation for 1928, and should have filed a separate Federal corporate income tax return for that year.

X.

The income of Trust No. P. T. 46, Pacific National Bank, Trustee, for 1928, should be excluded from Plaintiff's return and gross income.

XI.

If the income of Trust No. P. T. 46, Pacific National Bank, Trustee, for 1928, is excluded from Plaintiff's return and gross income, Plaintiff will have a loss, on which no tax is or was due, and Plaintiff is entitled to a refund of $9,669.89.

WHEREFORE, Plaintiff prays for judgment against the Defendant, GALEN H. WELCH, in the amount of $9,669.89, for 1928, together with interest at 6 per cent per annum from March 14, 1929, on $2,690.30; from June 12, 1929, on $2,690.30; from September 11, 1929, on $2,690.34; and from December 12, 1929, on $1,598.95; together with Plaintiff's costs of suit.

MILLER, CHEVALIER, PEELER & WILSON

By Melvin D. Wilson
Counsel for Plaintiff.

STATE OF CALIFORNIA)
) ss.
County of Los Angeles)

E. C. MAEDER, being by me first duly sworn, deposes and says:

That he is the Secretary of Pacific National Company, a corporation, the Plaintiff in the above entitled action, and as such officer is duly authorized to sign the foregoing Amended Complaint; that he has read the foregoing Amended Complaint to Recover Federal Corporate Income Taxes and knows the contents thereof; and that the same is true of his own knowledge, except as to the matters which are therein stated upon information or belief, and as to those matters that he believes it to be true.

E. C. Maeder

Subscribed and sworn to before me this 18th day of February, 1935.

[Seal] Mary McWaters
Notary Public in and for the County of Los Angeles, State of California.

My Commission Expires Dec. 1, 1935.

[For Exhibits "A" and "B" hereto attached see Stipulation of Facts incorporated in Engrossed Bill of Exceptions.]

[Endorsed]: Filed Feb. 19, 1935. R. S. Zimmerman Clerk By B. B. Hansen, Deputy Clerk.

[TITLE OF COURT AND CAUSE.]

ANSWER TO AMENDED COMPLAINT.

Comes now the defendant above-named, by and through his Attorneys, Peirson M. Hall, United States Attorney for the Southern District of California, Hugh L. Dickson, Assistant United States Attorney for said District, and Eugene Harpole, Special Attorney, Bureau of United States Internal Revenue, and in answer to the Amended Complaint on file herein, admits, denies and alleges, to-wit:

I.

The allegations of paragraph I of the Amended Complaint are admitted.

II.

The allegations of paragraph II of the Amended Complaint are admitted.

III.

The allegations of paragraph III of the Amended Complaint are admitted.

IV.

The allegations of paragraph IV of the Amended Complaint are admitted.

V.

The allegations of paragraph V of the Amended Complaint are admitted.

VI.

The allegations of paragraph VI of the Amended Complaint are admitted.

VII.

The allegations of paragraph VII of the Amended Complaint are admitted.

VIII.

Answering the allegations of paragraph VIII of the Amended Complaint, defendant admits that during the year 1928, the plaintiff was the sole beneficiary of Trust No. P. T. 46, Pacific National Bank, Trustee. All other allegations in said paragraph VIII are denied.

IX.

Answering the allegations of paragraph IX of the Amended Complaint, defendant admits that Trust No. P. T. 46, Pacific National Bank, Trustee, kept its books on the cash basis. All other allegations of said paragraph are denied for lack of sufficient knowledge or information upon which to form a belief as to the truth or falsity thereof.

X.

The allegations of paragraph X of the Amended Complaint are admitted except it is denied that plaintiff's action in reporting the net income of Trust No. P. T. 46, Pacific National Bank, Trustee, therein mentioned was erroneous.

XI.

The allegations of paragraph XI of the Amended Complaint are denied.

XII.

The allegations of paragraph XII of the Amended Complaint are denied.

XIII.

The allegations of paragraph XIII of the Amended Complaint are denied.

XIV.

The allegations of paragraph XIV of the Amended Complaint are denied as immaterial and in this connection it is alleged that the fiduciary return therein mentioned was filed January 3, 1935, and subsequent to the commencement of this action.

XV.

The allegations of paragraph XV of the Amended Complaint are denied except it is admitted that the defendant has not, nor has anyone for him repaid or refunded the sum or any part thereof involved in this action.

ANSWERING THE PLAINTIFF'S SECOND CAUSE OF ACTION:

I.

Defendant realleges as through here set forth, the answers given above to paragraphs I, II, III, IV, V, VI, VII, VIII, IX, X, XII and XV.

II.

The allegations of paragraph II of the Second alleged Cause of Action are denied.

III.

The allegations of paragraph III of the Second alleged Cause of Action are denied except it is admitted that a Revenue Agent's report was made, dated June 16, 1931.

IV.

The allegations of paragraph IV of the Second alleged Cause of Action are denied.

V.

The allegations of paragraph V of the Second alleged Cause of Action are denied.

VI.

The allegations of paragraph VI of the Second alleged Cause of Action are denied except it is admitted that in a letter dated February 15, 1932, and addressed to the plaintiff, the Commissioner of Internal Revenue ruled that Trust No. P. T. 46, Pacific National Bank, Trustee, was not an association and that therefore Plaintiff's claim would be denied for $9,669.89 and allowed for $1,091.39.

VII.

Answering the allegations of paragraph VII of the Second alleged Cause of Action, defendant alleges that he has not sufficient knowledge or information upon which to form a belief as to the truth or falsity thereof and therefore denies the same.

VIII.

Answering the allegations of paragraph VIII of the Second alleged Cause of Action, defendant alleges that he has not sufficient knowledge or information upon which to form a belief as to the truth or falsity thereof and therefore denies the same.

IX.

The allegations of paragraph IX of the alleged Second Cause of Action of the Amended Complaint are denied.

X.

The allegations of paragraph X of the alleged Second Cause of Action of the Amended Complaint are denied.

XI.

Answering the allegations of paragraph XI of the alleged Second Cause of Action, defendant alleges that he does not have sufficient knowledge or information upon which to form a belief as to the truth or falsity thereof and therefore denies the same.

BY WAY OF FURTHER ANSWER AND AS HIS FIRST AFFIRMATIVE DEFENSE, THE DEFENDANT ALLEGES:

I.

That the plaintiff filed a corporate income tax return for the calendar year 1928, in which it reported income from Trust No. P. T. 46, Pacific National Bank, Trustee, on the closed transaction basis.

II.

That the plaintiff was, at the time of filing said return for the calendar year 1928, the sole beneficiary of said Trust, and that by its act of filing the return, it has elected to report the income of said Trust No. P. T. 46, Pacific National Bank, Trustee, upon the closed transaction basis.

BY WAY OF FURTHER ANSWER AND AS A SECOND AFFIRMATIVE DEFENSE, IT IS ALLEGED AS FOLLOWS:

I.

That plaintiff filed an additional claim for refund, a copy of which is hereto attached, marked Exhibit "A", and by reference made a part hereof, on April 4, 1932.

II.

That all of the tax sought to be recovered herein had been paid by the plaintiff to the defendant more than two years prior to April 4, 1932.

III.

That said claim for refund filed on April 4, 1932, requested the refund of the tax here involved, upon separate, new and distinct grounds from those set forth in its claim for refund filed on February 26, 1931.

IV.

That at the time of filing its claim for refund on April 4, 1932, plaintiff was barred, and its action outlawed by the Statute of Limitations applicable to the filing of claims for refund for the calendar year 1928.

WHEREFORE the defendant having fully answered the allegations of the Amended Complaint prays that he may have judgment against the plaintiff for his costs.

Dated: February 19, 1935.

Peirson M. Hall—E. H.
PEIRSON M. HALL, U. S. ATTORNEY,

Hugh L. Dickson – E. H.
HUGH L. DICKSON, ASST. U. S. ATTORNEY,

Eugene Harpole
EUGENE HARPOLE, SPECIAL ATTORNEY
U. S. BUREAU OF INTERNAL REVENUE

Counsel for Defendant.

EXHIBIT "A"

Form 843
Treasury Department
Internal Revenue Service
Revised June 1930

AMENDED CLAIM

To be Filed with the Collector where Assessment was Made or Tax Paid.

The Collector will indicate in the block below the kind of claim filed, and fill in the certificate on the reverse side.

COLLECTOR'S STAMP

Date Received
REfund of Tax Illegally Collected. Apr 4 1932

Refund of Amount Paid for Stamps Unused, or Used in Error or Excess.

Abatement of Tax Assessed (not applicable to estate or income taxes).

RECEIVED
APR 26 1932
CLAIMS CONTROL
SECTION

STATE OF CALIFORNIA)ss
401062-1929 List
COUNTY OF LOS ANGELES)

2228256

Name of taxpayer or purchaser of stamps PACIFIC NATIONAL COMPANY,

Business address PACIFIC NATIONAL BANK BUILDING

(Street) (City)

Residence Los Angeles, California. 1928

The deponent, being duly sworn according to law, deposes and says that this statement is made on behalf of the taxpayer named, and that the facts given below are true and complete:

1. District in which return (if any) was filed Sixth California.
2. Period (if for income tax, make separate form for each taxable year) from January 1 1928 to December 31, 1928.
3. Character of assessment or tax Corporation Income Tax
4. Amount of assessment, $10,761.28; dates of payment .....
5. Date stamps were purchased from the Government....
6. Amount to be refunded.....$ 10,761.28
7. Amount to be abated (not applicable to income or estate taxes).....
8. The time within which this claim may be legally filed expires, under Section 322 of the Revenue Act of 1928, on 12/121931 , 19

The deponent verily believes that this claim should be allowed for the following reasons:

On February 15, 1931, a claim for refund for $10,761.28, 1928 income tax was filed by claimant. The

Commissioner of Internal Revenue has not completed his examination of the claim, but it still considering it.

The ground for the original claim was that the income from a subdivision trust, of which claimant was the sole beneficiary, had been reported in claimant's return on the completed or accrual basis, while the correct method was the installment basis.

The Commissioner suggested that the claimant had elected to use the completed basis and was estopped from using the installment basis as grounds for a claim for refund.

Claimant now wishes to amend the claim by showing that the subdivision trust is a separate entity, an association taxable as a corporation, that it did not file a consolidated return with claimant in 1928, and that its 1928 income can not be included in claimant's income or return. Accordingly, the income of the subdivision trust must be excluded from claimant's 1928 income, and the tax paid thereon by claimant, refunded. This situation prevents the doctrine of estoppel from applying to this case.

(Signed) Pacific National Company
By Edgar F. Hughes,
Vice-president.

Sworn to and subscribed before
me this 1st day of April, 1932.
Norman C. Eckstein, Notary Public.
Signature of officer administering Oath
Title.

My Commission Expires Nov. 20, 1932.

STATE OF CALIFORNIA)
) ss.
COUNTY OF LOS ANGELES)

EUGENE HARPOLE, being first duly sworn deposes and says: That he is a Special Attorney for the United State Bureau of Internal Revenue and one of the attorneys for the defendant in the foregoing action. that he is authorized to and does make this verification for and on behalf of the said defendant for the reason that he is more conversant with the facts involved than said defendant and for the reason that said Defendant is not now Collector of Internal Revenue and does not have access to the official records in said case; that he has read the foregoing Answer and knows the contents thereof and that the matters and facts therein contained are true of his own knowledge, except as to the matters which are therein stated upon his information or belief, and as to those matters he believes it to be true.

Eugene Harpole
Special Attorney,
Bureau of U. S. Internal Revenue.

Subscribed and sworn to before me
this 19 day of February, 1935.
[Seal] F. G. Albright
NOTARY PUBLIC.

NOTARY PUBLIC in and for the County of Los Angeles, State of California My Commission Expires Oct 22, 1936

[Endorsed]: Received copy this 19 day of Feb. 1935 Melvin D Wilson Counsel for Plaintiff Filed Feb. 19 1935. R. S. Zimmerman Clerk By B. B. Hansen, Deputy Clerk.

[TITLE OF COURT AND CAUSE.]

STIPULATION WAIVING JURY

We, the Attorneys for the respective parties, hereby waive the trial to the jury of this cause and agree to submit the same to the Court without the intervention of a jury.

DATED: December 27, 1933.

MILLER, CHEVALIER, PEELER & WILSON

By Melvin D. Wilson

Counsel for Plaintiff.

DATED: Dec. 30, 1933.

Peirson M. Hall

Peirson M. Hall, U. S. Attorney

John R. Layng, Asst. U. S. Attorney

Alva C. Baird

Alva C. Baird, Asst. U. S. Attorney

Counsel for Defendant.

APPROVED:

Wm. P. James

United States District Judge.

[Endorsed]: Filed Jan. 9, 1934. R. S. Zimmerman Clerk By L. Wayne Thomas, Deputy Clerk.

[TITLE OF COURT AND CAUSE.]

FINDINGS OF FACT AND CONCLUSIONS OF LAW.

The above entitled case came on regularly for trial before the Court sitting without a jury, a jury having been waived in writing by the parties, Melvin D. Wilson appearing for the plaintiff, and Peirson M. Hall, United States Attorney for the Southern District of California, Hugh L. Dickson, Assistant United States Attorney for said District, and Eugene Harpole, Special Attorney for the United States Bureau of Internal Revenue appearing for the defendant, evidence, both oral and documentary, having been introduced and the Court having considered the evidence finds the following facts therefrom:

I.

That the cause arose under the laws of the United States pertaining to Internal Revenue, to-wit: the Revenue Act of 1928.

II.

That plaintiff herein is, and during all the times hereinafter mentioned was, a corporation organized under the Laws of the State of California, and has its principal office and place of business in the Pacific National Bank Building, 315 West Ninth Street, Los Angeles, California.

III.

That the Defendant, Galen H. Welch, was, from April 6, 1926, to June 30, 1933, the duly commissioned and

acting Collector of Internal Revenue for the Sixth Collection District of California, during all the times hereinafter mentioned, resided, and still resides, and has his office in the City of Los Angeles, County of Los Angeles, State of California.

IV.

That the plaintiff filed its corporation income tax return for the calendar year 1928 with the defendant on the 14th day of March, 1929.

V.

That the plaintiff prepared its 1928 income tax return from its books of account and upon the same basis upon which those books were kept.

VI.

That the corporate income tax return filed by plaintiff for the calendar year disclosed a tax of $10,761.28 to be due and said tax was paid to the defendant as follows:

March 14, 1929	$ 2,690.30
June 12, 1929	2,690.30
September 11, 1929	2,690.34
December 12, 1929	2,690.34

VII.

That during the entire calendar year of 1928, the plaintiff was the sole beneficiary of a trust known as P. T. No. 48, Pacific National Bank, Trustee, and the owner of over 80% of the capital stock of the said Pacific National Bank.

VIII.

The 1928 Federal Income Tax Return filed by Plaintiff reported an income of $89,677.34, and this income was made up as follows:

Income from Trust No. P. T. 46, Pacific National Bank, Trustee—		$137,007.17
Less:		
Loss of Plaintiff from its 1928 operations exclusive of the trust income	$11,480.37	
Statutory net losses of Plaintiff as follows:		
1925—	1,990.77	
1926—	9,708.66	
1927—	24,150.03	47,329.83
Net income as reported—		$ 89,677.34

The $137,007.17 representing the income of Trust No. P. T. 46, Pacific National Bank, Trustee, resulted from the sale of subdivision lots, and in the determination thereof said sales were treated as deferred payment sales not on the installment plan and the obligations of the purchaser were treated as having a fair market value equivalent to their face value.

IX.

Pacific National Bank, as Trustee of Trust No. P. T. 46, kept the books and records of the Trust on the cash receipts and disbursements basis. This Trustee did not

file a Fiduciary or other income tax return for the Trust for the years 1927 or 1928, nor did the successor Trustee do so prior to the institution of this action.

X.

That the plaintiff filed a claim for refund of the taxes paid for the calendar year 1928 on the 26th day of February, 1931, setting forth the following grounds for the allowance of the refund:

"The taxpayer is a California corporation, organized in 1925, and reported net losses and profits as follows: Year 1925, Net Loss—$1,990.77; 1926, Net Loss—$13,199.43; 1927, Net Loss—$24,150.03; 1928, Net Profit—$89,677.43; 1929, Net Loss—$59,091.70.

"In computing net profit for the year 1928 the taxpayer made the following errors:

"(1) No deduction was made for depreciation of buildings, equipment, etc.

"(2) No deduction was made for depletion of oil lease.

"(3) Profit from sales of real estate in a subdivision trust were erroneously reported as based on closed sales, although the sales were made on the installment basis and proceeds of sales and collections were allocated by the Trustee."

XI.

That the plaintiff filed a claim for refund of the taxes paid for the calendar year 1928 on the 4th day of April, 1932, setting forth the following grounds for the allowance of the refund:

"On February 15, 1931, a claim for refund of $10,761.28, 1928 income tax was filed by claimant. The

Commissioner of Internal Revenue has not completed his examination of the claim, but is still considering it.

"The ground for the original claim was that the income from a subdivision trust, of which claimant was the sole beneficiary, had been reported in claimant's return on the completed or accrual basis, while the correct method was the installment basis.

"The Commissioner suggested that the claimant had elected to use the completed basis and was estopped from using the installment basis as grounds for a claim for refund.

"Claimant now wishes to amend the claim by showing that the subdivision trust is a separate entity, an association taxable as a corporation, that it did not file a consolidated return with claimant in 1928, and that its 1928 income can not be included in claimant's income or return. Accordingly, the income of the subdivision trust must be excluded from claimant's 1928 income, and the tax paid thereon by claimant, refunded. This situation prevents the doctrine of estoppel from applying to this case."

XII.

On the 17th day of May, 1932, the Commissioner of Internal Revenue allowed Plaintiff's claim for refund filed February 26, 1931, to the extent of $1,091.39 (upon grounds not in issue here) and rejected it as to the balance.

XIII.

That the Commissioner of Internal Revenue on July 25, 1932, confirmed the rejection of May 17, 1932, of claims for refund of taxes for the year 1928, and in said ruling of July 25, 1932, said Commissioner considered

all claims for refunds that had been theretofore filed by plaintiff taxpayer.

XIV.

That the plaintiff filed no claims for refund of the tax involved in this action other than those filed February 26, 1931, and April 4, 1932.

XV.

The issue that Trust No. P. T. 46, Pacific National Bank, Trustee, was an association taxable as a corporation and not as a Trust was not presented to the Commissioner of Internal Revenue in any claim for refund filed prior to April 4, 1932, and this claim for refund was not filed within two years from the date of payment of any portion of the tax reported for the calendar year 1928.

XVI.

The plaintiff filed no claim for refund which presented the contention sought to be raised at the trial, that the obligations of the purchasers of lots from Trust No. P. T. 46, Pacific National Bank, Trustee, had a fair market value less than the equivalent of their face value.

XVII.

That the plaintiff employed one Frank J. Brick on or about the 24th day of October, 1927, to put on a sales campaign of subdivision lots included in the holdings of Trust No. P. T. 46, Pacific National Bank, Trustee; that with the knowledge, consent, acquiescence and approval of the plaintiff, said Frank J. Brick put on a very successful high pressure sales campaign wherein he employed the free lunch and lecture system. That plaintiff obtained and retained financial benefit and income from the sales made by said Brick.

CONCLUSIONS OF LAW

From the Stipulation of Facts filed herein February 19, 1935, and from the foregoing Findings of Fact, the Court concludes as a matter of law:

I.

That there is no substantial or sufficient evidence before the Court upon which to base a judgment for the Plaintiff.

II.

That for the calendar year 1928, the plaintiff filed a corporate income tax return that met the requirements of the Internal Revenue Act and the Regulations of the Treasury Department and that said return was compiled from and made on the basis upon which the plaintiff kept its books of account.

III.

That the plaintiff has not filed a claim for refund in compliance with the provisions of Sec. 3226 Revised Statutes as to the contention that the obligations of the lot purchasers had a fair market value less than the equivalent of their face value and is not entitled to rely upon that contention in this action.

IV.

That Trust No. P. T. 46, Pacific National Bank, Trustee, is a fixed trust in the nature of a mortgage, and being a security device and not an association taxable as a corporation, as the entity involved in Trust No. 5833 was determined to be by this Court in 50 Fed. (2d) 614, and by the Ninth Circuit Court of Appeals in 54 Fed. (2d) 323.

V.

That the claim for refund that was filed by Plaintiff taxpayer on April 4, 1932, is an amendment of a claim for refund that was seasonably filed by the plaintiff taxpayer on February 26, 1931, and that said claim for refund dated April 4, 1932, is not barred by any statute of limitations.

VI.

That the plaintiff by its action in filing an income tax return for the calendar year 1928, in which it reported the proceeds from the sale of lots from the subdivision trust held by Trust P. T. 46, Pacific National Bank, Trustee, upon the deferred payment plan rather than the installment plan, exercised an election as to the method of reporting said sales, which election became final and binding upon the expiration of the time for filing income tax returns for the calendar year 1928 by this plaintiff.

VII.

That the defendant is entitled to recover judgment from the plaintiff herein for his costs to be taxed.

Dated This 8th Day of March, 1935.

Paul J. McCormick
United States District Judge.

[Endorsed]: Filed Mar. 8, 1935 R. S. Zimmerman Clerk By B. B. Hansen, Deputy Clerk.

At a stated term, to wit: The February Term, A. D. 1935, of the District Court of the United States of America, within and for the Central Division of the Southern District of California, held at the Court Room thereof, in the City of Los Angeles on Friday the 8th day of March in the year of our Lord one thousand nine hundred and thirty-five

Present:

The Honorable Paul J. McCormick, District Judge.

PACIFIC NATIONAL COMPANY, a corporation,

Plaintiff, No. 5827-M

vs.

GALEN H. WELCH, Former Collector of Internal Revenue for the Sixth District of California,

Defendant.

Findings and judgment are ordered for defendant herein, together with his costs of suit

Findings of fact and conclusions of law proposed by the plaintiff are not adopted by the Court, and are ordered filed herein, and in lieu of such proposed findings, the Court has this day made and filed herein its findings of fact and conclusions of law. Exceptions noted and allowed to the plaintiff.

IN THE DISTRICT COURT OF THE UNITED STATES IN AND FOR THE SOUTHERN DISTRICT OF CALIFORNIA CENTRAL DIVISION

PACIFIC NATIONAL COMPANY, a corporation,	)	
Plaintiff,	)	NO. 5827-M
vs.	)	JUDGMENT.
GALEN H. WELCH, Former Collector of Internal Revenue for the Sixth District of California,	)	
Defendant.	)	

The above entitled cause came on regularly for trial on the 19th day of February, 1935, before the Court sitting without a jury, a jury having been waived in writing by the parties, Melvin D. Wilson, Esq., appearing for the plaintiff, and Peirson M. Hall, United States Attorney for the Southern District of California, Hugh L. Dickson, Assistant United States Attorney for said District, and Eugene Harpole, Special Attorney for the United States Bureau of Internal Revenue appearing for the defendant; and evidence both oral and documentary having been introduced and the cause submitted for de-

cision, and the Court having heretofore made and caused to be filed herein its written Findings of Fact and Conclusions of Law;

IT IS ORDERED, ADJUDGED and DECREED that the plaintiff take nothing upon its complaint; that judgment be awarded against the plaintiff and in favor of the defendant herein for his costs to be taxed.

Approved as to Form as provided by Rule 44:

Melvin D. Wilson
Counsel for Plaintiff.

Judgment entered and recorded Apr. 5-1935 R. S. ZIMMERMAN Clerk By Murray E. Wire Deputy Clerk

[Endorsed]: Filed Apr. 5-1935 R. S. Zimmerman Clerk By Murray E. Wire, Deputy Clerk.

[TITLE OF COURT AND CAUSE.]

STIPULATION TO MINIMIZE PRINTED RECORD ON APPEAL

Pursuant to Rule 23 (8) of the United States Circuit Court of Appeals for the Ninth Circuit, the parties hereto, through their respective counsel, do hereby stipulate and agree that the printed transcript of record on appeal may be minimized as follows:

I.

Exhibit No. 1 in the Engrossed Bill of Exceptions is a copy of Plaintiff's 1928 Corporation Income Tax Return. As to this Exhibit, the printer may omit all parts of the return which were not filled out with Plaintiff's figures or answers; that is, the printer may print only such parts of the return as are not stricken out on the copy of the return attached hereto.

II.

Exhibit No. 2, in the Engrossed Bill of Exceptions, may be omitted and the following summary of that Exhibit may be printed in lieu thereof:

"Exhibit No. 2 is a written contract between Pacific National Company and Transamerica Corporation, dated December 23, 1931. In the contract Pacific National Company assigned to Bank of America National Trust and Savings Association various assets, including 29,188-14/100 shares of the capital stock of Transamerica Corporation, and the beneficial interest of Pacific National Company in the Trust S-1542, Title Guarantee and Trust Company, but excluding the claim of Pacific National Company for a refund of 1928 income taxes. In con-

sideration of said assignment, Transamerica Corporation released Pacific National Company from any further obligation or liability or guarantee which might exist under and by reason of an agreement between the parties dated July 17, 1929 and supplemental and extension agreements."

III.

Exhibit No. 11, in the Engrossed Bill of Exceptions, consists of two parts, a Fiduciary Return of Income for 1927 and a similar return for 1928. These returns may be called Parts I and II. Each Part consists of Form 1041, printed by the Treasury Department and a schedule of lot sales.

As to the printed Form 1041, the printer may omit all printed lines and language where the return is not filled out with figures or answers; that is, the printer may print only such parts of the return as are not stricken out on the copy of the return attached hereto.

As to the schedule of lot sales, the printer may leave out the part stricken out on the attached copies of the schedules. It is hereby stipulated that details as to each lot sold in 1927 and 1928, respectively, were given, as shown in the sample line on each schedule.

IV.

Exhibit "D", of the Stipulation of Facts, part of the Engrossed Bill of Exceptions, is a copy of the Declaration of Trust, Trust No. P. T. 46, Pacific National Bank, Trustee. This Exhibit may be minimized as follows:

The description of the property, contained on pages 1 to 7 inclusive, down to the paragraph on page 7, beginning "That no consideration has been paid by said Trustee . ." may be omitted by the printer.

V.

That in printing this Stipulation there may be omitted the Exhibits attached hereto for the purpose of giving instructions for the printer.

VI.

That if, in preparing the briefs or oral argument in this case, it develops that additional portions of the record should have been included in the printed transcript, the Defendant may supplement the record, or either party may transmit the original exhibits to the United States Circuit Court of Appeals.

DATED: July 26, 1935.

Melvin D. Wilson
MELVIN D. WILSON
Counsel for Plaintiff.

Peirson M. Hall – E. H.
Peirson M. Hall, U. S. Attorney
Hugh L. Dickson – E. H.
Hugh L. Dickson, Asst. U. S. Attorney
Eugene Harpole
Eugene Harpole, Special Attorney,
Bureau of Internal Revenue.
Counsel for Defendant.

APPROVED: July 30, 1935.

Paul J. McCormick
Judge of the United States
District Court.

[Endorsed]: Filed Jul 30, 1935. R. S. Zimmerman Clerk By Edmund L. Smith Deputy Clerk.

[TITLE OF COURT AND CAUSE.]

ENGROSSED BILL OF EXCEPTIONS

BE IT REMEMBERED that on the 19th day of February, 1935, the above entitled cause came on for trial before this Court, Honorable Paul J. McCormick presiding, the Court sitting without a Jury, trial by Jury having been waived in writing by counsel for the respective parties, a true copy of said Stipulation being as follows:

"IN THE DISTRICT COURT OF THE UNITED STATES IN AND FOR THE SOUTHERN DISTRICT OF CALIFORNIA CENTRAL DIVISION

PACIFIC NATIONAL COMPANY, a corporation, Plaintiff, vs. GALEN H. WELCH, Collector of Internal Revenue for the Sixth District of California, Defendant.	No. 5827-M STIPULATION WAIVING JURY

We, the Attorneys for the respective parties, hereby waive the trial to the jury of this cause and agree to sub-

mit the same to the Court without the intervention of a jury.

DATED: December 27, 1933.

MILLER, CHEVALIER, PEELER & WILSON
By Melvin D. Wilson
Counsel for Plaintiff.

DATED: Dec. 30, 1933.

PEIRSON M. HALL
Peirson M. Hall, U. S. Attorney
John R. Layng, Asst. U. S. Attorney
ALVA C. BAIRD
Alva C. Baird, Asst. U. S. Attorney
Counsel for Defendant.

APPROVED: January 9, 1934.
WM. P. JAMES
United States District Judge"

In the trial the following proceedings were had and the following testimony given:

Melvin D. Wilson, Esq., appearing for Plaintiff, and Peirson M. Hall, Esq., United States Attorney for the Southern District of California, Hugh Dickson, Esq., Assistant United States Attorney for said District, and Eugene Harpole, Esq., Special Attorney for the Bureau of Internal Revenue, appearing for the Defendant.

Mr. Melvin D. Wilson made an opening statement to the Court on behalf of the Plaintiff, and Mr. Eugene Harpole made an opening statement to the Court on behalf of the Defendant, whereupon Mr. Wilson replied to Mr. Harpole's statement, and thereupon the following proceedings were had, and evidence and testimony, oral and

documentary, were introduced in evidence on behalf of Plaintiff and on behalf of Defendant as follows:

The Plaintiff introduced an Amended Complaint. The Defendant objected to the filing of the Second Cause of Action in said Amended Complaint, on the ground that it was immaterial. The Court overruled the objection and allowed the Defendant an exception. The Defendant then filed an Answer to the Amended Complaint.

The Plaintiff introduced into evidence the following Stipulation as to certain facts which had been agreed to by the parties:

The Defendant objected to the introduction of Paragraphs VI, X, XV and XVIII of said Stipulation of Facts, upon the ground that they were immaterial and redundant.

IN THE UNITED STATES DISTRICT COURT IN AND FOR THE SOUTHERN DISTRICT OF CALIFORNIA CENTRAL DIVISION

PACIFIC NATIONAL COMPANY, a corporation, Plaintiff, vs. GALEN H. WELCH, Former Collector of Internal Revenue for the Sixth District of California, Defendant.	At Law No. 5827-M STIPULATION OF FACTS

IT IS HEREBY STIPULATED, by and between the respective parties hereto, through their respective counsel,

that the following facts are true, and, subject to all objections as to their relevancy or materiality, may be received into evidence, with the right reserved to either party to offer additional evidence not inconsistent with the facts embodied in this Stipulation.

I.

That the jurisdiction of this Court is dependent upon a Federal question in that the cause arises under the laws of the United States pertaining to Internal Revenue, to-wit: The Revenue Act of 1928.

II.

Plaintiff herein is, and during all the times hereinafter mentioned was, a corporation organized under the Laws of the State of California, and has its principal office and place of business in the Pacific National Bank Building, 315 West Ninth Street, Los Angeles, California.

III.

That the Defendant, Galen H. Welch, was, from April 6, 1926, to June 30, 1933, the duly commissioned and acting Collector of Internal Revenue for the Sixth Collection District of California, pursuant to the Laws of the United States, and during all the times hereinafter mentioned, resided, and still resides, and has his office in the City of Los Angeles, County of Los Angeles, State of California.

IV.

That this action is brought against the Defendant as a former officer acting under and by virtue of the Revenue Act of 1928, in effect for the year 1928, on account of acts done under color of his office and of the Revenue

Laws of the United States, as will hereinafter more fully appear.

V.

That Plaintiff filed with the proper officer designated by Statute, its corporation income tax return for the calendar year 1928, as required by law, within the statutory period, to-wit: on or about the 14th day of March, 1929, and paid a tax to the Defendant of $10,761.28, as follows:

March 14, 1929 –	$ 2,690.30
June 12, 1929 –	2,690.30
September 11, 1929 –	2,690.34
December 12, 1929 –	2,690.34
Total –	$10,761.28

VI.

That thereafter, to-wit: on the 26th day of February, 1931, Plaintiff, in the time and manner provided by law and regulations for filing claims for refund, filed with the Defendant and with the Commissioner of Internal Revenue, its claim for the refund of said tax amounting to $10,761.28, a copy of which Claim is attached hereto and marked Exhibit "A". On April 4, 1932, the Plaintiff filed a Claim for the refund of said tax amounting to $10,761.28, with the Defendant and with the Commissioner of Internal Revenue, a copy of said Claim is attached hereto and marked Exhibit "B".

VII.

That on or about the 17th day of May, 1932, the Commissioner of Internal Revenue rejected that portion of Plaintiff's Claim for Refund, filed February 26, 1931, which pertained to the grounds set forth in this cause of action. The Commissioner allowed Plaintiff's Claim for Refund, filed February 26, 1931, in the amount of $1,091.39, together with interest thereon, based on other grounds not material to this suit.

VIII.

During the year 1928, the Plaintiff was the sole beneficiary of Trust No. P. T. 46, Pacific National Bank, Trustee.

IX.

The 1928 Federal Income Tax Return filed by Plaintiff reported an income of $89,677.34, and this income was made up as follows:

Income from Trust No. P. T. 46, Pacific National Bank, Trustee –		$137,007.17
Less:		
Loss of Plaintiff from its 1928 operations exclusive of the trust income –	$11,480.37	
Statutory net losses of Plaintiff as follows:		
1925 –	1,990.77	
1926 –	9,708.66	
1927 –	24,150.03	47,329.83
Net income as reported –		$ 89,677.34

The $137,007.17 representing the income of Trust P. T. 46, Pacific National Bank, Trustee, resulted from the sale of subdivision lots, and in the determination thereof said sales were treated as deferred payment sales not on the installment plan and the obligations of the purchaser were treated as having a fair market value equivalent to their face value.

X.

The Bank of America National Trust & Savings Association succeeded the Pacific National Bank as Trustee of Trust No. P. T. 46. As successor Trustee, the Bank of America National Trust & Savings Association, on January 3, 1935, filed, with the Collector of Internal Revenue for the Sixth Collection District of California, a Fiduciary return for the year 1928, for the said Trust.

XI.

Pacific National Bank, as Trustee of Trust No. P. T. 46, kept the books and records of the Trust on the cash receipts and disbursements basis. This Trustee did not file a Fiduciary or other income tax return for the Trust for the years 1927 or 1928.

XII.

Plaintiff, throughout 1928, owned over 95 per cent of the stock of Pacific National Building Corporation. Plaintiff and Pacific National Building Corporation filed separate Federal corporation income tax returns for 1928.

XIII.

Plaintiff purchased the legal title to certain real property for $309,000.00 cash and a further investment of $300,000.00 represented by its Notes Payable. This property was conveyed to the Pacific National Bank in trust as Trustee for Trust No. P. T. 46 and under the Trust Indenture the Plaintiff became the sole beneficiary of said Trust.

XIV.

Throughout 1928, Plaintiff owned over 80 per cent of the stock of Pacific National Bank.

XV.

On October 24, 1927, Plaintiff employed Frank J. Brick as sales agent. The contract with Mr. Brick is attached as Exhibit "C".

XVI.

Plaintiff had numerous stockholders throughout 1928.

XVII.

Attached as Exhibit "D", is a copy of the Trust Indenture of Trust No. P. T. 46, Pacific National Bank, Trustee.

XVIII.

Attached as Exhibit "E", is a copy of the Installment Sales Contract used by Trustee in selling lots in 1928.

XIX.

It is further stipulated that upon the decision of this Court upon the legal questions involved, the determina-

tion of the correct amount of tax on the basis of such decision shall be referred back to the parties for agreement. If the parties are unable to agree upon such determination, each shall submit its computation to this Court and each shall have the right to introduce further evidense as to any necessary figures.

DATED this 18 day of February, 1935.

MELVIN D. WILSON
Melvin D. Wilson
Attorney for Plaintiff

PEIRSON M. HALL
Pierson M. Hall
United States Attorney

EUGENE HARPOLE
Eugene Harpole
Assistant United States Attorney

Attorneys for Defendant.

APPROVED:

PAUL J. McCORMICK
United States District Judge.

EXHIBIT "A"

CLAIM

Form 843

Treasury Department

Internal Revenue Service

Revised June, 1930

To Be Filed With the Collector Where Assessment Was Made or Tax Paid

---

The Collector will indicate in the block the kind of claim filed, and fill in the certificate on the reverse side.

[In box]: Collector's Stamp (Date received)

[xx] Refund of Tax Illegally Collected.

[ ] Refund of Amount Paid for Stamps Unused, or Used in Error or Excess.

[ ] Abatement of Tax Assessed (not applicable to estate or income taxes).

STATE OF California }
COUNTY OF Los Angeles } ss:

[In box]: Type or Print

Name of taxpayer or purchaser of stamps Pacific National Company

Business address 822 Pacific National Building – Ninth and Hill Sts.

(Street) (City) (State)

Residence Los Angeles, California

The deponent, being duly sworn according to law, deposes and says that this statement is made on behalf of the taxpayer named, and that the facts given below are true and complete:

1. District in which return (if any) was filed Sixth California – Los Angeles

2. Period (if for income tax, make separate form for each taxable year) from Jan. 1, 1928, to Dec 31, 1928

3. Character of assessment or tax Income tax.

4. Amount of assessment, $.....; dates of payment .....

5. Date stamps were purchased from the Government .....

6. Amount to be refunded..... $10,761.28

7. Amount to be abated (not applicable to income or estate taxes)..... $.....

8. The time within which this claim may be legally filed expires, under Section ..... of the Revenue Act of 19....., on ..... 19.....

The deponent verily believes that this claim should be allowed for the following reasons:

The taxpayer is a California corporation, organized in 1925, and reported net losses and profits as follows:

Year 1925, Net Loss—$1,990.77; 1926, Net Loss—$13,199.43; 1927, Net Loss—$24,150.03; 1928, Net Profit—$89,677.43; 1929, Net Loss—$59,091.70.

In computing net profit for the year 1928 the taxpayer made the following errors:

(1) No deduction was made for depreciation of buildings, equipment, etc.

(2) No deduction was made for depletion of oil lease;

(3) Profit from sales of real estate in a subdivision trust were erroneously reported as based on closed sales, although the sales were made on the installment basis and proceeds of sales and collections were allocated by the trustee.

(Attach letter size sheets if space is not sufficient)

Signed PACIFIC NATIONAL COMPANY
J. T. Duncan
Secy.

Sworn to and subscribed before me this
25 day of February, 1931

....., ...

(Signature of officer administering oath) (Title)

(See Instructions on Reverse Side)

[Blank Form of Certificate.]

INSTRUCTIONS

1. The claim must set forth in detail and under oath each ground upon which it is made, and facts sufficient to apprise the Commissioner of the exact basis thereof.

2. The claim should be sworn to by the taxpayer, if possible. Whenever it is necessary to have the claim executed by an attorney or agent, on behalf of the taxpayer, an authenticated copy of the document specifically authorizing such agent or attorney to sign the claim on behalf of the taxpayer shall accompany the claim. The oath will be administered without charge by any collector, deputy collector, or internal revenue agent.

3. If a return is filed by an individual and a refund claim is thereafter filed by a legal representative of the deceased, certified copies of the letters testamentary, letters of administration, or other similar evidence must be annexed to the claim, to show the authority of the executor, administrator, or other fiduciary by whom the claim is filed. If an executor, administrator, guardian, trustee, receiver, or other fiduciary files a return and thereafter refund claim is filed by the same fiduciary, documentary evidence to establish the legal authority of the fiduciary need not accompany the claim, provided a statement is made on the claim showing that the return was filed by the fiduciary and that the latter is still acting.

4. Where the taxpayer is a corporation, the claim shall be signed with the corporate name, followed by the signature and title of the officer having authority to sign for the corporation.

EXHIBIT "B"

Form 843
Treasury Department
Internal Revenue Service
Revised June, 1930

AMENDED CLAIM

(Copy)

To Be Filed With the Collector Where Assessment Was Made or Tax Paid

---

The Collector will indicate in the block below the kind of claim filed, and fill in the certificate on the reverse side.

[In box]: Collector's Stamp (Date received) Received Apr 4 1932 Coll. Int. Rev. 6th Dist. Cal.

[ ] Refund of Tax Illegally Collected.

[ ] Refund of Amount Paid for Stamps Unused, or Used in Error or Excess.

[ ] Abatement of Tax Assessed (not applicable to estate or income taxes).

STATE OF California }
COUNTY OF Los Angeles } ss:

[In box]: Type or Print

Name of taxpayer or purchaser of stamps PACIFIC NATIONAL COMPANY

Business address Pacific National Bank Building,
(Street) (City) (State)

Residence Los Angeles, California.

The deponent, being duly sworn according to law, deposes and says that this statement is made on behalf of the taxpayer named, and that the facts given below are true and complete:

1. District in which return (if any) was filed Sixth, California
2. Period (if for income tax, make separate form for each taxable year) from January 1, 1928, to December 31, 1928
3. Character of assessment or tax Corporation Income Tax
4. Amount of assessment, $.....; dates of payment .....
5. Date stamps were purchased from the Government .....
6. Amount to be refunded..... $10,761.28
7. Amount to be abated (not applicable to income or estate taxes)..... $.....
8. The time within which this claim may be legally filed expires, under Section ..... of the Revenue Act of 19....., on ..... 19.....

The deponent verily believes that this claim should be allowed for the following reasons:

On February 15, 1931, a claim for refund for $10,761.28, 1928 income tax was filed by claimant. The Commissioner of Internal Revenue has not completed his examination of the claim, but is still considering it.

The ground for the original claim was that the income from a subdivision trust, of which claimant was the sole

beneficiary, had been reported in claimant's return on the completed or accrual basis, while the correct method was the installment basis.

The Commissioner suggested that the claimant had elected to use the completed basis and was estopped from using the installment basis as grounds for a claim for refund.

Claimant now wishes to amend the claim by showing that the subdivision trust is a separate entity, an association taxable as a corporation, that it did not file a consolidated return with claimant in 1928, and that its 1928 income can not be included in claimant's income or return. Accordingly, the income of the subdivision trust must be excluded from claimant's 1928 income, and the tax paid thereon by claimant, refunded. This situation prevents the doctrine of estoppel from applying to this case.

(Attach letter size sheets if space is not sufficient)

Signed PACIFIC NATIONAL COMPANY
By Edgar F. Hughes
Vice President

Sworn to and subscribed before me this
1st day of April, 1932

Norman C. Eckstein Notary Public
(Signature of officer administering oath) (Title)

My Commission Expires Nov. 20, 1932.

(See Instructions on Reverse Side)

[Blank Form of Certificate.]

INSTRUCTIONS

1. The claim must set forth in detail and under oath each ground upon which it is made, and facts sufficient to apprise the Commissioner of the exact basis thereof.

2. The claim should be sworn to by the taxpayer, if possible. Whenever it is necessary to have the claim executed by an attorney or agent, on behalf of the taxpayer, an authenticated copy of the document specifically authorizing such agent or attorney to sign the claim on behalf of the taxpayer shall accompany the claim. The oath will be administered without charge by any collector, deputy collector, or internal revenue agent.

3. If a return is filed by an individual and a refund claim is thereafter filed by a legal representative of the deceased, certified copies of the letters testamentary, letters of administration, or other similar evidence must be annexed to the claim, to show the authority of the executor, administrator, or other fiduciary by whom the claim is filed. If an executor, administrator, guardian, trustee, receiver, or other fiduciary files a return and thereafter refund claim is filed by the same fiduciary, documentary evidence to establish the legal authority of the fiduciary need not accompany the claim, provided a statement is made on the claim showing that the return was filed by the fiduciary and that the latter is still acting.

4. Where the taxpayer is a corporation, the claim shall be signed with the corporate name, followed by the signature and title of the officer having authority to sign for the corporation.

EXHIBIT "C"

SALES CONTRACT

THIS AGREEMENT made in duplicate this 24th day of October, 1927 between PACIFIC NATIONAL COMPANY, a California corporation, having its head office and chief place of business in the City of Los Angeles, County of Los Angeles, State of California, hereinafter referred to as the Owner, party of the first part, and FRANK J. BRICK, duly licensed under the laws of the State of California to carry on business as a real estate broker and conducting business in the name of FRANK J. BRICK COMPANY (of which Frank J. Brick is sole owner and proprietor) with offices located at 619 West 8th Street, in the City of Los Angeles, County of Los Angeles, State of California, hereinafter referred to as Agent, party of the second part;

WHEREAS, the party of the first part is the beneficial owner of those certain lots situated in Tract No. 10078 of Los Angeles County, known as Culver City Park in Culver City, in said Los Angeles County, State of California, as per map recorded in Book 141, Pages 23, 24 and 25 of Maps, Records of Los Angeles County, as shown on, and enumerated in, the schedule of lots hereto attached, marked "Exhibit A" and hereby referred to and made a part hereof, and

WHEREAS, the legal title of said lots is vested in The Pacific National Bank of Los Angeles, which holds said title in trust for the benefit of the said PACIFIC NATIONAL COMPANY, and

WHEREAS, said PACIFIC NATIONAL COMPANY, herein referred to as Owner, has agreed to employ said FRANK J. BRICK as its agent to sell said lots,

NOW THEREFORE, THIS AGREEMENT WITNESSETH:

The Owner hereby employs the Agent as its exclusive selling agent to procure customers for all of said lots, shown in the schedule hereto attached, at the respective selling prices shown in said schedule and upon the terms herein set forth.

The Owner agrees to install, with all reasonable diligence, the local street improvements already contracted for by it, and also to cause electricity, gas and water, for use by lot purchasers, to be brought to the tract with due diligence, and to pay the cost of such local improvements.

The Agent agrees that he will devote his entire time and that of his organization to the performance of this agreement until all said lots are sold; that he will conduct a diligent and energetic selling campaign; that he will give the offering wide publicity and will advertise the same freely in the press and by the distribution of printed circulars and pamphlets; and that he will pay the entire selling expenses, including sub-agents' and salesmens' commissions, cost of advertising and publicity, clerks' hire and his organization's office overhead.

It is understood that all sales contracts shall be issued by The Pacific National Bank of Los Angeles, as the legal owner of said lots; shall be in the form prepared by said bank and shall contain the conditions and restrictions printed in such form of contract. It is further agreed that all payments on account of the purchase price of said lots shall be made to the said bank.

It is agreed that the terms of any sale shall require at least twenty-five (25) per cent as an initial and down

payment and that the balance of the purchase price shall be paid in equal monthly payments, each of which payments shall amount to at least one and one-half (1½) per cent of the gross selling price of each lot sold, or in equal quarterly payments amounting to at least four and one-half (4½) per cent of the gross selling price of each lot sold, or in equal semi-annual payments, amounting to at least nine (9) per cent of the gross selling price of each lot sold, such payments to include interest at the rate of seven (7) per cent per annum; provided, always, that the unpaid balance of the purchase price shall in no event be deferred for more than five (5) years from the date of each respective contract. If the installment payments herein mentioned to be made within five years on any contract are not sufficient to pay the whole unpaid principal with interest at seven (7) per cent per annum, as herein provided, then any remaining balance shall be by the terms of the contract paid five years from the date of the contract.

It is further agreed that a sale for cash may be made of any lot upon the basis of a price which shall equal ninety-five (95) per cent of the selling price, as shown on the schedule hereto attached.

This agreement, unless sooner terminated, shall continue from the date hereof until January 1, 1929, provided, however, that the said Agent shall make and close bona fide sales (including the procuring of the down payments to be paid to said bank) in each month during the existence of this contract, commencing November 1, 1927, which shall amount to the sum of Fifty Thousand Dollars ($50,000.00) upon the basis of the selling prices shown in schedule hereto attached, except that during the months

of November and December of each year the minimum selling requirements under this contract shall be Twenty-five Thousand Dollars ($25,000.00) per month. In the event the minimum selling requirements are not met in any month, the Owner may terminate this contract upon five (5) days notice in writing to the Agent, which notice may be forwarded by registered post to the Agent at his last known residence or business address, and the time shall commence to run upon the mailing of such notice. A failure by the Owner to exercise its right to terminate this contract by reason of the non-production of the minimum sales herein required in any month, shall not constitute a waiver of the right by the Owner to terminate the same for failure to produce the amount of minimum sales in any subsequent month.

For his services and due performance of this agreement, the Agent shall, (subject to the terms and conditions of payment thereof herein provided,) receive a commission equal to thirty-five percent (35%) of the actual selling price of each lot sold, where such selling price is not in excess of the price set forth in the schedule hereto attached, payable as follows:

To the Agent shall be paid an amount equal to eighty-eight percent (88%) of the down payment received by the said bank, on each sale, provided the down payment is not in excess of twenty-five percent (25%) of the selling price;

To the Agent shall also be paid amounts equal to forty percent (40%) of all other and subsequent payments received by the said bank on account of the principal of the selling price (but not the interest thereon), until the

Agent's thirty-five percent (35%) commission of the actual selling price shall have been paid in full.

It is understood that should any contract or contracts lapse before the Agent has received the commission herein provided thereon, the Agent is to receive only the percentages herein mentioned payable on receipt of the installments received by the bank up to the time of cancellation. In case of default the Owner shall exercise its best judgment and discretion in regard to enforcing the provisions of the contract regarding such default, and as to which of the several remedies provided in the contract of sale or by law shall be pursued; and in the event that, under a purchaser's contract, his rights to purchase are cancelled and the title quieted against him, the lot upon which said contract is so cancelled shall be put back on the market by the Agent under the same commission and terms as herein provided in the first instance, provided, however, that the Agent's employment to resell any such lots, as to which the contract has been cancelled, shall not extend beyond the expiration or termination of this agreement.

The Agent promises and agrees that he will not make, or permit his assistants or salesmen to make, any misrepresentations or misstatements of fact to induce purchasers to buy said lots, either verbally or in advertisements or otherwise, and the Owner shall have the right, provided any misrepresentations be made by the Agent, his assistants or salesmen, as aforesaid, immediately to terminate and cancel this agreement, as to all unsold lots, and it is a condition upon which this agreement is entered into by the Owner that no misrepresentations or misstatements of fact shall be made.

It is further understood that the Owner shall have the sole right to change the selling price of any of the unsold lots, to be sold under this contract, by giving the Agent thirty (30) days notice in writing of any such desire to change; it being understood and agreed that such change shall be reasonable considering market conditions at the time of such change.

Should the price at which any lot is sold be greater than the price set forth in the schedule hereto attached, then a sum equal to fifty percent (50%) of the amount by which the sale price exceeds the price set forth in the schedule hereto attached, shall be paid to the agent, in addition to the basic commission of thirty-five percent (35%) on the schedule selling price; provided that the payment of the additional commission shall be payable only as follows:

After the full thirty-five percent (35%) commission on the original schedule selling price shall have been paid to the agents, at the times and in the manner hereinbefore provided, the owner shall cause to be paid to the agent, as each subsequent installment of principal is received on account of the purchase, an amount which shall bear to the amount of principal received the proportion which the unpaid balance of the agent's commission bears to the unpaid balance of the principal of the purchase price, less such unpaid commission. As in the case of the original thirty-five percent (35%) commission, the payment of the additional commission shall at all times be contingent upon the receipt by said bank of the instalments of principal upon receipt of which, as hereinbefore provided, such proportionate payments of commission are to be made to the Agent.

The Owner shall (providing a contract of sale shall have been entered into by the purchaser and approved by the bank), cause the said bank to pay to the Agent his proportion of the commission dependent upon the receipt of the down payment on each sale, within three (3) days after the bank shall have received such down payment; and where checks are received on account of a down payment, the bank shall not be deemed to have received such down payment until such checks have been cleared and collected by the bank.

The Owner shall cause the said bank to render each month to the Agent a statement showing the condition of payments upon all contracts of sale up to the time of such statement; also, shall cause said bank, with such monthly statement, to pay to the Agent all commissions then due and payable to the Agent and not theretofore paid to the Agent (all as in this agreement provided).

The covenants and provisions hereof shall inure to the benefit of, and be binding upon, the heirs, executors, administrators, successors and assigns of the respective parties; but the agent shall have no right to assign this agreement in whole or in part without the consent of the owner —the owner having contracted in reliance on the personal moral character of the Agent. In the event that the Agent shall die or for any reason be permanently physically or mentally unable to give personal attention to the performance of this agreement, the Owner may at any time thereafter, notwithstanding any other provisions of this agreement elect, without notice, to terminate this agreement as to all lots not sold.

IN WITNESS WHEREOF, the party of the first part has caused its corporate name and seal to be hereunto affixed, by its proper officers thereunto duly authorized, and the party of the second part has hereunto set his hand and seal, all on the day and year in this Agreement first above written.

PACIFIC NATIONAL COMPANY, a corporation

By (Signed) Fred Swensen
Its Vice President

(SEAL)

And (Signed) F. M. Shelton
Its Secretary

Party of the first part

(Signed) Frank J. Brick

Party of the second part

Lot No.	Price	Lot No.	Price	Lot No.	Price
1	$8500	61	$4500	121	$3445
2	5000	62	4000	122	3250
3	5000	63	4000	123	2285
4	5000	64	4000	125	2285
5	5000	65	4000	126	2285
6	9000	66	4000	127	2285
7	10494	67	4000	128	2285
8	5000	68	4000	129	2285
9	5000	69	4000	138	2850
10	5000	70	3700	139	2765
11	5000	71	3700	145	2285
12	5000	72	3700	146	2275

13	5000	73	3700	147	2265
14	5000	74	3700	148	2255
15	9620	75	3700	149	2245
16	9620	76	3700	150	2245
17	4500	77	3700	151	2255
18	4500	78	3700	153	2285
19	4500	79	3700	156	3445
20	4500	80	3300	157	2285
21	4500	81	3300	158	2215
22	4500	82	3300	159	2215
23	4500	83	3300	161	2185
24	9620	84	3300	162	2175
25	9620	85	3300	163	2145
26	4500	86	3300	164	2125
27	4500	87	3300	165	2085
28	4500	88	3300	166	2065
29	4500	89	3400	167	2245
30	4500	90	3475	168	2165
31	4500	91	3700	169	2165
32	4500	92	4000	170	2165
33	8750	93	6250	172	2165
34	8750	94	9450	173	2165
35	4500	95	3750	174	2165
36	4500	96	3350	175	2165
37	4500	97	3000	176	2245
38	4500	98	3000	177	2265
39	4500	99	3000	179	3345
40	4500	100	3000	180	2265
41	4500	101	3000	182	2255
42	8750	102	3000	184	2255
43	8750	103	3000	185	2265

44	5000	104	3000	186	2275
45	5000	105	3000	187	2285
46	5000	106	3000	188	2295
47	5000	107	3000	189	2315
48	5000	108	3000	190	2325
49	5000	109	3000	191	2345
50	5000	110	3000	193	2365
51	8750	111	3000	194	2375
52	6250	112	2350	195	3145
53	5000	113	2185	196	2910
54	5000	114	2185	197	2375
55	5000	115	2185	198	2385
56	5000	116	2185	199	2375
57	5000	117	2185	200	2365
58 and 59	25000	118	2185	201	2355
60	5400	119	2185	202	2345
				203	2335

Lot No.	Price	Lot No.	Price	Lot No.	Price
205	$2325	270	$7250	332	$2485
206	2315	271	4500	333	4250
207	2295	272	3900	334	2860
208	2285	273	2435	335	1945
209	2285	274	2435	336	1945
211	2265	275	2395	337	1945
212	2950	276	2365	338	1945
213	4450	277	2325	339	1945
214	2265	278	3450	340	1945
215	2255	279	2445	341	1945
216	2215	280	2445	342	1945
218	2165	281	2545	343	1945

219	2165	283	3900	345	1945
220	2165	282	2365	346	1955
221	2155	284	4500	347	1965
222	2145	285	4875	348	1975
223	2135	286	2385	350	2065
224	2135	287	2385	351	2145
225	2245	288	2385	352	3465
226	2345	289	2385	353	3650
227	2285	290	2385	354	2345
228	2295	291	2385	355	2295
229	2325	292	2385	356	2285
230	2375	293	2385	357	2285
231	2435	294	2385	358	2295
232	2535	295	2385	360	2315
233	2635	296	2385	361	2315
234	2745	297	2385	362	2315
235	2865	298	3145	363	2345
236	2885	299	2940	364	2365
237	2925	300	2385	365	2385
238	2935	301	2385	366	3145
239	2985	302	2385	367	2940
240	4880	303	2385	368	2465
241	4350	304	2385	369	2455
245	2365	305	2385	371	2445
246	2365	306	2385	372	2435
247	2365	307	2385	373	2425
248	2365	308	2385	374	2415
249	2365	309	2385	375	2405
250	2365	312	4875	376	2395
251	2365	313	4350	378	2385
252	2365	314	3450	379	2385
253	2365	315	3350	380	3685

254	2365	316	3250	381	3465
255	2385	317	3250	382	2385
256	3145	318	3250	383	2385
257	2940	319	3250	384	2375
258	2385	320	3250	385	2365
259	2385	321	3250	386	2335
260	2385	322	3250	387	2310
261	2385	323	3250	388	2295
262	2385	324	3250	390	2275
263	2385	325	3150	391	2265
264	2385	326	3000	392	2255
265	2385	327	2900	393	2245
266	2385	328	2800	394	2235
267	2385	329	2700	395	2225
268	2385	330	2685	396	2215
269	2425	331	2865	398	2255

Lot No.	Price	Lot No.	Price	Lot No.	Price
399	$2965	467	$2560		
400	2860	468	2550		
401	2145	469	2540		
402	1945	470	2530		
403	2065	471	2645		
404	2100	472	3300		
405	2200	473	3840		
406	3100	474	2265		
407	3045	475	2255		
408	2385	476	2245		

409	2385	477	1965
410	2415	478	2650
411	2425		
412	2435		
413	2445		
414	2455		
415	2465		
416	2475		
417	2485		
418	2495		
419	2510		
420	2520		
421	2530		
422	2540		
423	2550		
424	2650		
425	4250		
426	4650		
427	2650		
428	2660		
429	2660		
430	2670		
431	2680		
432	2690		
433	2700		
434	2710		
437	2750		
438	2780		

439	3365
440	3145
443	2780
444	2770
445	2760
446	2760
447	2740
448	2730
449	2720
450	2710
451	2700
452	2725
453	4850
454	4345
455	2680
456	2670
457	2660
458	2650
459	2640
460	2630
461	2620
462	2610
463	2600
464	2590
465	2580
466	2570

EXHIBIT "D"

COPY

DECLARATION OF TRUST

TRUST NUMBER P T 46

KNOW ALL MEN BY THESE PRESENTS:

That THE PACIFIC NATIONAL BANK OF LOS ANGELES, a National Banking Association, organized and existing under the laws of the United States of America, with its office and principal place of business in the City of Los Angeles, County of Los Angeles, State of California, hereinafter called the "TRUSTEE", has received from the Pacific National Company, a corporation organized and existing under the laws of the State of California and having its principal office and place of business in the City of Los Angeles, County of Los Angeles, State of California, hereinafter called the "BENEFICIARY", a Deed dated.....1927, conveying to said Trustee that certain real property in Culver City, in the County of Los Angeles, State of California, described as follows:

"That certain property situated in the City of Culver City, County of Los Angeles, State of California.

* * * * * * * * *

That no consideration has been paid by said Trustee for the conveyance to it of the above described Trust Property.

That, WHEREAS, said Pacific National Company the Beneficiary above named, by its approval of this Declaration of Trust, acknowledges that it is indebted to H. W. McLeod, of the City of Los Angeles, County

of Los Angeles, state of California, hereinafter called the "PAYEE", in the principal sum of ($300,000.00) Three Hundred Thousand Dollars,, as evidenced by three certain promissory notes respectively (Hereinafter referred to as "SAID NOTES"), in words and figures as follows, to-wit:

Los Angeles, California, July 1st 1927.

$50,000.00

On or before the 15th day of July 1928, FOR VALUE RECEIVED, Pacific National Company, a corporation organized and existing under the laws of the State of California, promises and agrees to pay, or cause to be paid to H. W. McLeod, of the City of Los Angeles, County of Los Angeles, State of California, at The Pacific National Bank of Los Angeles, Hill at Ninth Street, Los Angeles, California, the principal sum of Fifty Thousand ($50,000.00) Dollars together with interest thereon at the rate of six (6%) per cent per annum, payable annually.

Also costs of collection and attorney's fees in a reasonable amount in case this note be not paid at maturity;

Should the interest not be so paid it shall become a part of the principal and thereafter bear like interest as the principal.

Should default be made in the payment of principal and/or interest when due, then the whole sum of principal and interest shall become immediately due and payable in gold coin of the United States of the present standard of weight and fineness.

This note is secured by a certain Declaration of Trust issued by The Pacific National Bank of Los Angeles, a

National Banking Association, dated July 1st 1927, and known as Trust No. P T 46 and is subject to the terms and conditions thereof.

PACIFIC NATIONAL COMPANY,

By sgd "Fred Swensen"
Vice President

By sgd "F. W. Shelton,"
Secretary

Los Angeles, California, July 1st 1927.

$50,000.00

On or before the 15th day of July 1929, FOR VALUE RECEIVED, Pacific National Company, a corporation organized and existing under the laws of the State of California, promises and agrees to pay, or cause to be paid to H. W. McLeod, of the City of Los Angeles, County of Los Angeles, State of California, at The Pacific National Bank of Los Angeles, Hill at Ninth Street, Los Angeles, California, the principal sum of Fifty Thousand ($50,000.00) Dollars together with interest thereon at the rate of six (6%) per cent per annum, payable annually.

Also costs of collection and attorney's fees in a reasonable amount in case this note be not paid at maturity;

Should the interest not be so paid it shall become a part of the principal and thereafter bear like interest as the principal.

Should default be made in the payment of principal and/or interest when due, then the whole sum of principal and interest shall become immediately due and payable

in gold coin of the United States of the present standard of weight and fineness.

This note is secured by a certain Declaration of Trust issued by The Pacific National Bank of Los Angeles, a National Banking Association, dated July 1st, 1927, and known as Trust No. P T 46 and is subject to the terms and conditions thereof.

PACIFIC NATIONAL COMPANY,
By sgd "Fred Swensen",
Vice President

by sgd "F. W. Shelton".
Secretary

Los Angeles, California, July 1st 1927.

$150,000.00

On or before the 15th day of July 1930, FOR VALUE RECEIVED, Pacific National Company, a corporation organized and existing under the laws of the State of California, promises and agrees to pay, or cause to be paid to H. W. McLeod, of the City of Los Angeles, County of Los Angeles, State of California, at The Pacific National Bank of Los Angeles, Hill at Ninth Street, Los Angeles, California, the principal sum of One Hundred and Fifty Thousand ($150,000.00) Dollars together with interest thereon at the rate of six (6%) per cent per annum, payable annually.

Also costs of collection and attorney's fees in a reasonable amount in case this note be not paid at maturity;

Should the interest not be so paid it shall become a part of the principal and thereafter bear like interest as the principal.

Should default be made in the payment of principal and/or interest when due, then the whole sum of principal and interest shall become immediately due and payable in gold coin of the United States of the present standard of weight and fineness.

This note is secured by a certain Declaration of Trust issued by The Pacific National Bank of Los Angeles, a National Banking Association, dated July 1st 1927, and known as Trust No. P T 46 and is subject to the terms and conditions thereof.

PACIFIC NATIONAL COMPANY,
By sgd "Fred Swensen",
Vice President
by sgd "F. W. Shelton".
Secretary

Los Angeles, California, July 1st 1927.

$50,000.00

On or before the 15th day of July 1931, FOR VALUE RECEIVED, Pacific National Company, a corporation organized and existing under the laws of the State of California, promises and agrees to pay, or cause to be paid to H. W. McLeod, of the City of Los Angeles, County of Los Angeles, State of California, at The Pacific National Bank of Los Angeles, Hill at Ninth Street, Los Angeles, California, the principal sum of Fifty Thousand ($50,000.00) Dollars together with interest thereon at the rate of six (6%) per cent per annum, payable annually.

Also costs of collection and attorney's fees in a reasonable amount in case this note be not paid at maturity;

Should the interest not be so paid it shall become a part of the principal and thereafter bear like interest as the principal.

Should default be made in the payment of principal and/or interest when due then the whole sum of principal and interest shall become immediately due and payable in gold coin of the United States of the present standard of weight and fineness.

This note is secured by a certain Declaration of Trust issued by The Pacific National Bank of Los Angeles, a National Banking Association, dated July 1st 1927, and known as Trust No. P. T. 46 and is subject to the terms and conditions thereof.

PACIFIC NATIONAL COMPANY,
By sgd "Fred Swensen",
Vice President
by sgd "F. W. Shelton".
Secretary

Which said indebtedness is hereby declared to be a first lien upon, and is deemed to be secured by, the Trust Property and the entire beneficial interest under this Trust, in the manner hereinafter provided;

NOW, THEREFORE, this DECLARATION OF TRUST,

WITNESSETH:

That said, THE PACIFIC NATIONAL BANK OF LOS ANGELES, Trustee hereunder, as aforesaid, here-

by CERTIFIED AND DECLARES that it holds and will hold such title to the real property as has been actually conveyed to it and/or shall thereafter become vested in it, IN TRUST for the benefit of said Pacific National Company, a corporation, the Beneficiary hereunder, for the purposes aforesaid, and upon all of the trusts, terms and conditions, covenants and ageements herein contained, all of which the Beneficiary and Payee, by their written approval hereof, agree and bind themselves, their successors and assigns, making themselves by such approval parties hereto, namely:

FIRST: The Beneficiary by its ratification and approval of this Declaration of Trust, does promise and agree;

(a) To pay, satisfy and discharge at least five (5) days before delinquency, all claims, taxes, liens, assessments, charges and encumbrances, affecting or purporting to affect adversely to the Trustee herein, title to any part of the said Real Property, and all costs, charges and expenses of this trust and Trustee's fees as herein provided, together with taxes of the fiscal year 1927-1928, and all charges taxes, liens and assessments hereafter attaching to, or becoming a lien on said Real Property.

(b) To institute, maintain, appear in or defend any action or proceeding affecting or purporting to affect the Real Property or title thereto, or this trust, or the rights of the Trustee, the Payee, or the Beneficiary, hereunder, and to protect and indemnify the Trustee to its satisfaction in taking any such action or proceeding, together with attorney's fees in a reasonable sum to be fixed by the Court, whether such action or proceeding progress to

judgment or not, and whether brought by or against the Trustee, the Payee, or the Beneficiary;

(c) To protect said Real Property in the event said Real Property is subdivided in the manner herein provided, and to pay, or cause to be paid, all costs and expenses of said subdivision, or subdivisions; and of all improvements hereafter made upon said Real Property, and to protect and save harmless said Trustee, said Payee, and said Real Property, of, from and against all damages and expense by reason of said subdivision and/or improvements of any character whatsoever made, or to be made, on said property, and, without demand, to furnish said Trustee indemnity in such an amount as said Trustee may deem necessary to protect the Trustee, the Payee, and/or the Real Property, from loss, damage and/or expense by reason of such subdivision and/or improvements;

(d) To pay within thirty (30) days from the date of advancement, and without demand, all sums advanced by the Trustee and/or the Payee under the terms hereof, with interest thereon from date of advancement until repayment at the rate of seven per cent. (7%) per annum;

(e) To pay the principal and interest upon said notes in the manner and at the times herein provided;

(f) If said Trust Property, or any part thereof, is subdivided by the Beneficiary, to cause to be prepared and filed with said Trustee a map of the property so subdivided, whereby said property is divided into Parcels or lots, and to pay all costs and expenses thereof.

That it will cause, from time to time, surveys to be made of those parcels or portions thereof of the property covered hereby, which it shall have elected to subdivide

into lots, and will cause a map of the survey of said subdivision, or subdivisions, to be prepared and presented to the Trustee for its approval, execution and acknowledgement; and after such approval, execution and acknowledgment thereof, said Beneficiary will cause said map to be filed for record in the office of the County Recorder of Los Angeles County, State of California, and to pay all costs and expenses of such subdivision, or subdivisions, and the improvement thereof;

(g) To contract for any and all labor and materials furnished in the improvement of said property and to obtain and file with said Trustee from each contractor who is to furnish labor, and from each materialman who is to furnish material, in connection with any and all work upon said property, and prior to the commencement of such labor, or prior to the delivery of such material, as the case may be, a waiver of his right of lien against said Trust Property, by reason thereof;

(h) That the acceptance by said Payee, or the Trustee for said Payee, of any sum or sums of principal, and/or interest secured hereby, after the date when such sum or sums shall become due and payable, or the performance of any other obligation by the Beneficiary after the date herein provided for the performance thereof, shall not operate as a waiver to the right to insist upon the payment of all other obligations promptly as herein provided; and to declare a default as herein provided for the failure to pay such sums or to perform such obligations promptly as herein provided;

(i) To perform each and every act herein provided to be performed by the Beneficiary.

SECOND: Should the Beneficiary fail or refuse to make any of the payments, or do any of the acts herein mentioned, in the manner and at the times herein provided, then the Trustee and/or the Payee, may without notice to or demand upon the Beneficiary, make or do the same in such manner and to such extent as they, or any of them, may elect; and may pay, purchase, contest, or compromise any claims, liens or encumbrances which, in their judgment, appear to affect said Trust Property or these trusts; but neither the Trustee nor the Payee shall be under any obligation to take any such action; and no such action of the Trustee or Payee shall affect or relieve the Beneficiary from any default.

THIRD: Should breach or default be made by the Beneficiary in payment of any indebtedness and/or in the performance of any obligation, covenant, promise or agreement herein mentioned, then the Payee may declare all sums secured hereby immediately due, and in such case, shall execute and deliver to the Trustee a written declaration of default and demand for sale and shall surrender to the Trustee any receipts or other documents evidencing any expenditure secured hereby. Thereafter there shall be recorded in the office of the Recorder of the County or Counties wherein said Real Property, or some part thereof, is situated, a notice of such breach of default and of election to sell or cause to be sold the herein described trust property to satisfy the obligations hereof.

After three months shall have elapsed following such recordation of said notice, the Trustee, without demand on the Beneficiary, shall sell said Trust Property as herein provided, having first given notice of the time and place of such sale in the manner and for a time not less than

that required by the laws of the State of California for sales of real property under Declarations of Trust.

The Trustee may postpone sale of all, or any portion, of said property by public announcement at the time fixed by said notice of sale, / and may thereafter postpone said sale from time to time by public announcement at the time fixed by the preceding postponement; and without further notice it may make such sale at the time to which the same shall be so postponed, provided, however, that the sale or any postponement thereof must be made at the place fixed by the original notice of sale.

provided the same is requested only by the Payee in writing

At the time of sale so fixed, the Trustee may sell the Trust Property so advertised, at public auction, to the highest bidder for cash in United States gold coin, all payable at time of sale, and after any such sale and due payment made, shall execute and deliver to such purchaser a deed and/or assignment conveying the Trust Property so sold, but without covenant or warranty, express or implied, regarding title, possession or incumbrances. The Beneficiary hereby agrees to surrender immediately and without demand possession of said Trust Property to such purchaser. The recitals in such deed and/or assignment of any matters or facts affecting the regularity or validity of said sale shall be conclusive proof of the truthfulness thereof and such deed and/or assignment shall be conclusive against all persons as to all matters or facts therein recited. The Trustee, or the Payee, or any person on behalf of either, or any other person, may purchase at such sale.

FOURTH: The Trustee shall apply the proceeds of any such sale to the payment of:

1. (a) Expenses of sale; (b) all costs, charges and expenses of the Trustee and of these trusts, including cost of evidence of title and Trustee's fee in connection with sale.

2. All sums expended under the terms hereof, not then repaid, with accrued interest at the rate of ten per cent per annum.

3. Accrued interest on said note, the payment of which is secured hereby.

4. Unpaid principal of said notes; and

5. The remainder, if any, to the person, or persons, legally entitled thereto, upon proof of such right.

FIFTH: (a) In the event of a default by the Beneficiary, and sale of the Real Property pursuant to the provisions of paragraphs Third and Fourth hereof, and at any sale or sales so conducted by the Truster after Default and pursuant to election and notice to sell, the property to be sold shall be the Real Property not theretofore conveyed by the Trustee or contracted by it to be sold to purchasers, together with all easements and/or rights of way (if any), reserved by the Trustee, and also the entire beneficial interest hereunder of the said Beneficiary in all contracts of sale of lots then outstanding and in the Improvement Fund, held by the Trustee under this Trust at the time of sale; and every other interest, right and privilege hereunder of the Beneficiary; but the Trustee shall retain the legal title to all of said Property covered by Contracts of sale issued by it, so as to enable it to carry out said contracts.

(b) All moneys in the hands of the Trustee at the time of said Notice of Default, and not received by the Trustee to be applied towards payment of the principal or interest on said promissory notes, and all moneys thereafter collected by the Trustee up to the time of sale (less Trustee's fees in every case) shall, at the election of the Payee, be paid over to the Payee, and the receipt thereof shall in no way cure the default, or, unless it be payment in full of the said notes with the Trustee's fees and disbursements, prevent the sale, but shall operate to reduce the balance owing from the Beneficiary.

(c) Collections received after the sale, from holders of outstanding contracts shall be distributed to the purchaser at the Trustee's sale, less the fees of the Trustee, in accordance with the schedule herein set forth, which may be retained by the Trustee from the amounts so collected; and when the terms of such contracts have been complied with by the purchasers of such lots, the Trustee shall convey the same to the purchasers without any liability except for the accounting for the moneys collected thereon.

SIXTH: Should the Payee become purchaser at the sale provided for in subdivisions THIRD AND FOURTH hereof, they shall not be required to pay cash in the full amount bid for the property, but they shall pay in cash the amount of the Trustee's fees and expenses of the sale, plus the excess, if any, bid over and above such fees and expenses, and over and above sums then owing to them from the Beneficiary; with such exceptions, the Payee may furnish to the Trustee receipts in lieu of cash bid.

PROVIDED, HOWEVER, that should there remain unsatisfied any portion of the indebtedness evidenced by the promissory notes hereinabove described, after the sale of the Trust Property hereunder and the application of the proceeds of such sale as herein provided, then and in that event the Trustee, if and when requested in writing by the Payee, shall take such further and/or other action to enforce payment of such deficiency as to said Trustee may seem proper; and PROVIDED, FURTHER, that such request of the Payee shall be accompanied by a sum of money, sufficient in the judgment of the Trustee, to cover all damages, costs and charges in connection therewith.

SEVENTH: The Policy of Title Insurance Number 38403, Order Number 947795, amount Six Hundred Nine Thousand ($609,000.00) Dollars, issued by the Title Insurance & Trust Company, a corporation of Los Angeles, dated the 16th day of April 1927, at 8 o'clock A. M., showing the title to the Trust Property vested in the Pacific National Company, subject to the liens, conditions, restrictions, reservations, rights and rights of way of record together with the recorded deed conveying said Trust Property from the Beneficiary, said Pacific National Company, to said Trustee The Pacific National Bank of Los Angeles, shall be sufficient evidence of title for the purposes of this Trust.

EIGHTH: After said deed shall have been recorded the Trust Property, or any portion thereof (subject to the provisions hereof) may be subdivided in such manner as the Beneficiary and the Trustee may determine, in which event the Trustee is authorized to execute and acknowledge for record such subdivision map and/or maps, as

may be approved in writing by the Beneficiary, and to dedicate to public use all streets, alleys and public places shown on said map, and to grant in and/or over such subdivision, rights of way and/or easements for public utilities.

The Trustee shall execute contracts of sale, or deeds, covering any part of said Trust Property or any of the lots shown on the map of the subdivision or subdivisions of said Trust Property filed with the Trustee by the Beneficiary, to purchasers upon the sole written instructions of the Beneficiary.

Lands covered hereby may be released provided no Declaration of Default and Demand for Sale be on file with said Trustee (under the provisions hereof) at time of demand and payment therefor, from the lien of the hereinbefore described debt, upon payment to said Trustee, for the account of the Payee hereunder, of the sum of Seven Hundred ($700.00) Dollars for each lot in said subdivision, until there shall have been paid into said indebtedness fund, under the provisions of this paragraph, an aggregate amount of principal equal to the balance then remaining unpaid on the indebtedness of the Beneficiary to the Payee hereunder, whereupon the whole of the Trust Property hereunder shall be released from the lien of the indebtedness hereinabove described.

PROVIDED, FURTHER, HOWEVER, that said Trust Property, or any part thereof, may be sold without same being subdivided.

The entire sales price of every lot or parcel of said Trust Property, together with all interest on each contract of sale shall be paid to the Trustee.

All moneys received by the Trustee derived from the sale of said lots or parcels of said Trust Property shall be distributed:

1st: To the payment of the costs, fees, expenses, damages, and advances (if any) with interest, hereunder of said Trustee;

2nd: To the payment of all expenses in connection with the sale of said Trust Property;

3rd: To the payment of taxes and assessments levied and assessed against the Trust Property;

4th: To the payment into an account designated the "IMPROVEMENT FUND", ten (10%) per cent of the selling price of such lots or parcels of said Trust Property, for the payment of the improvements (if any) to be placed upon said Trust Property by the Beneficiary, by and upon the written order of the Beneficiary. All moneys in the Improvement Fund which, in the discretion of the Trustee, are not required for the purposes thereof, shall be paid to or upon the written order of the Beneficiary;

5th: To the payment into a fund hereinafter called the "INDEBTEDNESS FUND," the sum of Seven Hundred ($700.00) Dollars for each lot sold where the sale is for cash; In cases where the sale is on contract with partial cash payment and the balances of the purchase price payable in deferred payments, fifty (50%) per cent of the moneys received after items 1st, 2nd, 3rd and 4th hereunder shall have been provided for, shall be paid into the indebtedness fund, for the account of the Payee hereunder.

PROVIDED, HOWEVER, that should 50% of the remaining moneys herein referred to, be not equal to the amount of the release price of the lot sold, then the Trustee shall pay into the Indebtedness Fund such greater percentage of the remainder of the sales prices as shall be equal to such release price.

PROVIDED, FURTHER, that should said 50% of the remainder of the sales price of any lot or parcel exceed the amount of the release price thereof, then the Trustee, at the request of the Beneficiary, may apply such excess towards the release price of any other lot or parcel of said Trust Property; and the Beneficiary shall at all times, upon payment of any part of the principal of said promissory notes, be entitled to releases of lots or parcels selected by it, the aggregate of the release prices of which are equivalent to the amount so paid;

6th: The balance to the Beneficiary.

NINTH: Interest upon the notes above described, payment of which is secured hereby as aforesaid, shall be payable only upon, and upon, an amount not exceeding the balances from time to time unpaid to the Payee.

Upon payment to the Payee of said notes and interest thereon, and upon payment in full of all sums owing to the Payee and secured hereby, all interest of said Payee in this Trust shall cease and terminate and the Trustee shall thereafter hold the Trust Property in Trust for the sole use and benefit of, and convey the same, in the manner herein provided, and subject to the terms and conditions hereof, upon the sole written instructions of the Beneficiary and distribute all sums distributable under the terms hereof to the Beneficiary.

TENTH: The Beneficiary herein named shall have the right and privilege of dividing its Beneficial Interest hereunder and assigning and transferring all or portions of said Beneficial Interest, subject to all of the terms, conditions, obligations and provisions hereof, PROVIDED, HOWEVER, that every such assignee or transferee shall accept a Certificate of Beneficial Interest issued by the Trustee in its usual form, and thereafter, said Trustee shall have full power and authority to make any distribution to the Beneficiaries under this Trust to the registered owners of such Certificates, in the proportion that the records of said Trustee show them to be entitled thereto, as and when each such distribution is made.

ELEVENTH: No sale or transfer of any interest represented by any Certificate of Beneficial Interest so issued by the Trustee hereunder shall be valid or binding upon said Trustee until the Certificate evidencing the Beneficial Interest so sold or transferred shall have been duly assigned, transferred and surrendered to said Trustee for cancellation, in accordance with its usual custom and practice; excepting only where such interest may pass or be transferred by Decree or Order of Court; and then only upon presentation to the Trustee of satisfactory proof of the validity and regularity of such Decree or Order, and the proceedings in connection therewith. In the event of the loss or destruction of any Certificate of Beneficial Interest so issued by the Trustee, the Trustee will issue a new Certificate of Beneficial Interest in lieu of such lost or destroyed Certificate only upon compliance with such terms and conditions as the Trustee may consider necessary or advisable for its protection. In the event of the hypothecation of any such Beneficial Interest hereunder

represented by Certificate of Beneficial Interest so issued by the Trustee, such hypothecation will not be valid as to, or binding upon, the Trustee unless and until the Certificate representing the Beneficial Interest so hypothecated shall have been duly endorsed and delivered to the Trustee for cancellation and issuance of a new certificate, evidencing the existence of such hypothecation, and in the event of the foreclosure thereof the Trustee shall not be required to recognize the transfer of interest as consummated by such foreclosure, unless and until presentation to the Trustee of satisfactory proof of the regularity and validity of the proceedings in connection with such foreclosure.

TWELFTH: In the event any portion of the interest of the Beneficiary hereunder shall be transferred pursuant to the provisions hereof, each such transfer shall be made subject to any and all obligations imposed upon the Beneficiary herein named by the terms hereof; and such transferee or transferees shall contribute toward the payment of said note and interest thereon, together with all liens, encumbrances, taxes, assessments and other charges against the Trust Property, in proportion to their respective Beneficial Interests hereunder, at the times such charges become due and payable.

If any Beneficiary hereunder fails to pay his proportionate share of any sum whatsoever (before such sum becomes due), properly payable in connection with this Trust by the Beneficiaries hereunder, then, any other Beneficiary of this trust may pay or advance the same and shall thereupon be entitled to a lien upon the interest of the Beneficiary so failing to contribute, for any sums so advanced, together with interest at seven per cent.

(7%) per annum from date of advancement until repaid, said lien being enforceable in the manner herein provided. Upon the failure of any beneficiary to contribute as above provided, and upon the execution and delivery to the Trustee herein named, of a written Declaration of Default and Demand for Sale, either by the Beneficiary making an advance as above provided, or by a majority in interest of the then Beneficiaries of this trust, and without the necessity of making demand upon the beneficiary so failing to contribute, the Trustee shall sell the interest hereunder of the beneficiary so failing to contribute, or such part thereof as it shall deem necessary to sell in order to pay the amount due from such beneficiary, in the following manner, namely:

Said Trustee shall first publish notice of the time and place of such sale with a description of the interest to be sold, either twice a week for three successive weeks, or, within the sole discretion of the Trustee, at least once a week for six successive weeks, in some newspaper of general circulation published in the City of Los Angeles, California, and may from time to time postpone such sale by publication of a notice of postponement in the same manner, or, at its option, by public announcement thereof at the time and place of sale so advertised; and at the time and place of sale so fixed, said Trustee may sell said interest, or any portion thereof, at public auction to the highest bidder for cash, in gold coin of the United States, and the Trustee or any Beneficiary or Payee hereunder, or any person on behalf of either, or any firm, corporation or other person, may bid and purchase at such sale; and after such sale and after due payment made, said Trustee shall execute and deliver to the purchaser, or pur-

chasers, at such sale, an assignment, or assignments, of the interest, or interests, in this trust so sold to such purchaser or purchasers, SUBJECT, however, to all of the terms and conditions of this trust.

The Beneficiary for itself, its successors and assigns, does hereby assign, transfer and convey to said Trustee, title to its Beneficial Interest hereunder, sufficient to enable it to convey and assign all or any portion of said Interest upon a sale thereof, as above provided; and whenever it is necessary to give any act of said Trustee legal force or effect, said Trustee shall be taken as, and its said act as done by, the attorney in fact of any such Beneficiary of this trust; and any transfer of beneficial interest under this trust by the Beneficiaries hereunder shall be made and accepted subject to the foregoing transfer of Beneficial Interest and to the power and authority vested in the Trustee as aforesaid; and the Beneficiary herein named, by its approval hereof, and any person who shall hereafter become a Beneficiary of this Trust, by the acceptance of a Beneficial Interest hereunder, does make, constitute and appoint said Trustee, its attorney in fact, for the uses and purposes herein provided, thereby ratifying and confirming all that said attorney-in-fact may do in the premises.

In the event of a sale of any portion of the Beneficial Interest hereunder, and after such sale and due payment made thereon, said Trustee shall execute and deliver to the purchaser or purchasers evidence of a transfer of the Interest hereunder so sold to such purchaser or purchasers, but without covenant or warranty, express or implied, regarding title thereto, and any Beneficial Interest so purchased shall be subject to all of the terms and conditions

herein set forth; and the recitals in the assignment or assignments or evidence of transfer of interest so executed by said Trustee of default, publication of notice of sale, demand that such sale should be made, postponement of sale, terms of said sale, purchasers, payment of purchase money, and any other fact affecting the regularity and validity of such sale, shall be conclusive against all persons as to all matters recited therein. Demand and notice of the time and place of sale or postponement of sale are hereby waived by the Beneficiary herein named, and by any person who shall become beneficially interested hereunder.

Said Trustee shall apply the proceeds of such sale or sales to the payment of the following amounts:

(a) To the expense of such sale, including posting and advertising, together with costs, fees and charges, and expenses of the Trustee and of these trusts, and counsel fees, in a reasonable sum, and said Trustee's fees of One Hundred Dollars for making said sale; which said amounts shall become due and payable upon the first publication by the Trustee of the notice of such sale;

(b) To all sums which may have been paid or advanced in accordance with the provisions hereof, and not repaid, together with accrued interest thereon.

AND, LASTLY, any balance to the person or persons entitled thereto.

If the amount received upon any such sale shall be insufficient to pay the charge against the Interest sold, then the difference shall be pro-rated among the Beneficiaries, according to their respective interests.

THIRTEEN: Anything herein contained to the contrary notwithstanding, in the event of a sale of the Trust Property, or in the event of a sale of a Beneficial Interest hereunder, pursuant to the provisions hereof, the Payee shall have no cause of action for any personal judgment against any person who shall hereafter become a Beneficiary of this trust, except for the proportionate part thereof represented by the proportionate Beneficial Interest hereunder acquired by such successor.

FOURTEENTH: The Trustee shall not be answerable or responsible for the validity of the conveyance to it of the Trust Property, nor the value thereof, nor the title thereto, nor for any easements, liens, encumbrances, restrictions or other clouds thereon, or claims thereto,—the sole, only and exclusive liability of the Trustee being to convey, in the manner and for the purposes and duration of this Trust, as herein provided, such title to the Trust Property as has actually been conveyed to it, or may hereafter become vested in it, and by it accepted in trust hereunder, and to distribute any moneys received by it as Trustee hereunder, in the manner herein provided, and to do and perform such other acts as are herein specifically required by and of it.

FIFTEENTH: The Trust hereby created shall, in any event, cease and terminate upon the expiration of a period of twenty (20) years after the date of this Declaration, on which termination and upon full release of the Trustee

from any liability hereunder, and after payment in full of any and all charges, fees, expenses and advances of the Trustee, with interest thereon, any and all property remaining in this Trust shall be conveyed, assigned and transferred to the persons then lawfully entitled thereto.

SIXTEENTH: The Trustee is hereby given a first lien upon the entire trust estate as security for any sums advanced by it for the protection of said Trust Property, and for its compensation which is hereby fixed as follows:

(a) An acceptance fee of One Thousand Two Hundred and Fifty ($1,250.00) Dollars;

(b) The sum of $5.00 for each deed executed by it;

(c) The sum of $5.00 for each contract executed by it;

(d) The sum of $5.00 for each transfer of Beneficial Interest, to be paid by the transferror;

(e) On all moneys paid to the Trustee, for the service of receiving and disbursing, same as hereinbefore provided, five (5%) per cent;

(f) Closing fee Two Thousand Five Hundred ($2,500.00) Dollars;

(g) An additional reasonable compensation for any unusual, special or extraordinary services which the Trustee may render;

SEVENTEENTH: THIS TRUST shall not cease or terminate in any event until all of the costs, fees, expenses and advances, with interest, hereunder of said Trustee,

and all liabilities and damages incurred or sustained by said Trustee by reason of its acceptance and/or administration of this Trust, shall have been fully paid.

THE CONDITIONS and provisions hereof shall inure to and shall bind said Trustee, said Beneficiary, said Payee, their successors and assigns.

IN WITNESS WHEREOF, the said THE PACIFIC NATIONAL BANK OF LOS ANGELES, a National Banking Association, as Trustee, has caused these presents to be duly signed by its Vice President and Assistant Trust Officer, and has caused the seal of said THE PACIFIC NATIONAL BANK OF LOS ANGELES, to be hereunto affixed this First day of July, 1927.

THE PACIFIC NATIONAL BANK OF LOS ANGELES, a National Banking Association, Trustee

By sgd "A. M. DeLong,
Vice-President

By sgd "F. J. Renders".
Assistant Trust Officer.

WE, THE UNDERSIGNED, do hereby certify and declare that the foregoing Declaration of Trust No. P. T 46, correctly and accurately sets forth and declares the trust under and upon which said Property is held by said Trustee, and do also hereby agree to do, and do approve, ratify and confirm the same in all particulars; and the

undersigned Beneficiary does undertake in favor of the Trustee, and also in favor of the Payee, the strict and timely performance, and agrees to perform each and every promise, obligation and covenant assumed or undertaken or recited in the foregoing Declaration of Trust, to be or to have been performed, undertaken or agreed to by it, intending hereby to effect the execution of the foregoing instrument.

AND the undersigned Beneficiary also hereby transfers and conveys to said Trustee title to the Beneficial Interest thereunder for conveyance of said Interest, or part or parts thereof, in event of a sale as therein provided.

PACIFIC NATIONAL COMPANY, a corporation,
BENEFICIARY

sgd By "Fred Swensen"
(SEAL) Vice President

sgd By "F. W. Shelton"
Secretary.

.....
PAYEE.

Subscribed and sworn to before me this ..... day of ....., 1927.

.....
Notary Public in and for the County of Los Angeles, State of California

EXHIBIT "E"

AGREEMENT FOR THE SALE OF REAL ESTATE

THIS AGREEMENT, Made and entered into this ..... day of ..... 192...., Between THE PACIFIC NATIONAL BANK OF LOS ANGELES, a National Banking Association, the party of the first part, hereinafter sometimes designated the Seller, and .... whose residence and postoffice address is ..... the party of the second part, hereinafter sometimes designated the Buyer.

WITNESSETH: That the said Seller in consideration of the covenants and agreements on the part of the said Buyer hereinafter contained, agrees to sell and convey unto the said Buyer, and the said Buyer agrees to buy from said Seller all of that real property situate in the City of Culver City, County of Los Angeles, State of California, described as follows: Lot No. ..... of Tract No. 10078, as per map recorded in Book 141, pages 23, 24 and 25 of maps, in the office of the County Recorder of said County.

THE PURCHASE price mutually agreed upon is the sum of ..... Dollars ($.....) which the said Buyer agrees to pay to the said Seller in gold coin of the United States of the present standard of weight and fineness at the office of said Seller in Los Angeles, California, or at such other places as may be designated by the Seller, as follows, to-wit: The sum of ..... Dollars ($.....) upon the execution of this Agreement, the receipt whereof is endorsed hereon; and the balance of $..... in installments of $.....

each, due on the ..... day of each and every month, commencing ....., ... and continuing until the total purchase price, together with interest on all deferred payments, at the rate of seven per cent (7%) per annum, payable ....., is fully paid. Buyer may make larger payments or at more frequent intervals than those set forth above.

The Buyer agrees, during the term of this Agreement, or any extension or renewal thereof, to pay to the Seller all assessments and taxes of every kind and nature now or hereafter levied or assessed against said property, including street and other improvements, except as hereinafter provided, assessments, water rates, telephone rates, street lighting charges, electric lighting and gas charges, if any, which may be taxed, charged, assessed, levied or imposed upon said property, or upon any improvements thereon, or upon the estate hereby created, or upon the interest therein of any of the parties thereto; all such taxes, assessments and other charges to be paid at least ten days before the same become delinquent, including the ..... installment of City and County taxes for the fiscal year 192.... 192..... Upon failure so to do, the Seller shall have the right to pay the same, together with any and all costs, penalties and legal percentages which may be added thereto; and the amount so paid, with interest thereon, at the rate of seven per centum (7%) per annum from the date of payment until repaid shall be secured hereby and shall be repaid by said Buyer to said Seller on demand, and failure by the Buyer to repay the same, with such interest, within thirty (30) days after such demand by the Seller shall constitute a default under the terms of this Agreement.

IT IS UNDERSTOOD AND AGREED that the property above described has been inspected by the Buyer or the Buyer's duly authorized agent; that the same is and has been purchased by the said Buyer as a result of said inspection and upon the Buyer's own judgment, and not upon representation made by said Seller or any selling agent, and said Buyer hereby expressly waives any and all claims for damages by reason of any cancellation or foreclosure of this contract because of any representation made by any selling agent or person whatsoever other than is contained in this contract, and the said Seller shall not be responsible or liable for any inducement, promise, representation, agreement, condition or stipulation not set forth herein.

IT IS FURTHER AGREED that time is of the essence of this Agreement, and full performance by the Buyer of all of his obligations hereunder is and shall be a condition precedent to his right to a conveyance hereunder; and, should default be made in the payment of any of said installments of principal or interest when the same become due, or in the repayment on demand of any amount therein agreed to be repaid, or in the performance of any other obligation hereunder, then the whole unpaid balance of said purchase price and all advancements theretofore made, with the interest thereon, shall become immediately due and payable at the option of the Seller who may thereupon at its option, enforce its rights hereunder either by forfeiture of all the Buyer's rights under this Agreement and all interest in the lands described herein and the appurtenances as hereinafter provided, or by an action in equity or at law for specific performance with damages, or for the recovery of the

purchase price with interest; and nothing herein contained shall be construed as depriving the Seller of any legal or equitable right or remedy it may have in the premises; and no court of law, or equity shall relieve the Buyer upon failure to comply strictly and literally with the terms of this Agreement. The Buyer agrees to pay all costs and expenses of any action commenced by the Seller to enforce this Agreement, including attorney's fees, whether such action progress to judgment or not. If the Seller elects to enforce its rights of forfeiture hereunder it may do so by serving on Buyer, personally, or mailing to his last known address, a written declaration of said election. Upon said forfeiture all rights of the buyer or any person claiming under him shall terminate, and all equitable or legal interests in the premises, improvements and appurtenances shall revert to the Seller, without any rights in the Buyer for recovery of, or damages for, any money paid, services performed, or improvements placed on said land. And the money paid and improvement erected shall be forfeited to and be retained by said Seller, as liquidated damages for such default and not as a penalty, and the Seller shall have the right immediately upon any default in performance on the part of the Buyer to enter upon said premises and take possession thereof, with or without process of law. No waiver by Seller of a breach of any condition, restriction or agreement herein shall be deemed a waiver of any succeeding breach of the same or any other condition, restriction or covenant herein.

As soon as the Buyer shall have made said payments, including taxes and assessments, as aforesaid, if made within the time and manner aforesaid, and surrendered his duplicate original hereof, said Seller shall, and it does

hereby agree to convey or cause to be conveyed said premises to the said Buyer and to furnish a Certificate or Guarantee of Title of Security Title Insurance and Guarantee Company, showing title to said lands to be vested in the grantor named in said deed, free of incumbrance, made or suffered by said Seller at the date of said conveyance, except as herein mentioned. The liability to be shown in said guarantee shall not exceed said purchase price.

It is especially understood and agreed that said Buyer shall not place or maintain, or permit to be placed or maintained upon said premises any signs or billboards of whatsoever nature prior to the time that said purchase price is fully paid and deed executed hereunder, it being the desire of said Seller to do everything on its part to make said tract a clean and attractive subdivision and that the beauty of said tract shall not be marred by any signs or billboards of any nature or description.

This agreement is made by the Seller and executed by the Buyer subject to the conditions, restrictions, reservations and easements hereinafter recited, which it is hereby agreed shall apply to said land as well before the execution and delivery of said deed by the said Seller as after said deed has been executed and delivered, and shall also be written in and become a part of said deed. Said conditions and restrictions substantially are in the words and figures following, to-wit:

"This property is conveyed by said first party and the said conveyance is accepted by said second party subject to conditions, restrictions, reservations and easements now of record and the following conditions and covenants,

which shall apply to and be binding upon the said party of the second part, his heirs, devisees, executors, administrators and assigns, and shall be construed and enforced both as covenants running with the land and as conditions, namely:

"A". That lots 1 to 111, both inclusive, of said Tract No. 10078, are hereby designated as business lots and may be used for all lawful purposes except as hereinafter stated (it being understood that no manufacturing may be carried on, on said lots), provided, however, that any building erected on any of said lots 1 to 59, both inclusive must be neat and attractive in appearance and must cost and be fairly worth at time of construction not less than $3500.00, that any building erected on any of said lots 60 to 111, both inclusive must be neat and attractive in appearance and must cost and be fairly worth at time of construction not less than $2500.00. Every such building, except for automobile service stations, erected on any of said lots must be of cement, stucco or brick construction, and must be built flush with the front property line of such lot. That the design for the exterior of all buildings to be erected or constructed on said lots 1 to 111, both inclusive shall be submitted for approval to an architectural committee to be appointed by the Grantor.

"B". That lots 112 to 166, both inclusive shall be used for single family residence exclusively and such residence erected thereon shall be fairly worth not less than $3500.00, and shall face the front line of said lots, and shall be located not less than 20 feet from the front line thereof.

Lots 167 to 225, both inclusive, and lots 333 to 402, both inclusive, shall be used for single family residence exclu-

sively, and such residence erected thereon, shall be fairly worth not less than $4000.00, and shall face the front line of said lots, and shall be located not less than 20 feet from the front line thereof.

Lots 226 to 232, both inclusive, lots 245 to 269, both inclusive, lots 273 to 282, both inclusive, lots 287 to 311, both inclusive, and lots 326 to 332, both inclusive, shall be used for single family residence exclusively, and such residence erected thereon, shall be fairly worth not less than $5000.00, and shall face the front line of said lots, and shall be located not less than 20 feet from the front line thereof.

Lots 233 to 244, both inclusive, lots 270 to 272, both inclusive, lots 283 to 286, both inclusive, and lots 312 to 325, both inclusive, shall be used for single family residence exclusively, and such residence erected thereon, shall be fairly worth not less than $6000.00, and shall face the front line of said lots, and shall be located not less than 20 feet from the front line thereof.

Lots 403 to 477, both inclusive, shall be used for residence or residential income purposes only, and any dwelling erected thereon shall cost and be fairly worth not less than $4000.00 for single family residence; $7500.00 for double bungalow and/or duplex, and shall face the front line of said lots, and shall be located not less than 20 feet from the front line thereof.

"C". That no temporary dwellings of any description whatsoever, including garages or any outbuildings used for residence purposes, shall ever be constructed or occupied for residence purposes upon said premises.

"D". That no house or other building shall ever be moved on to any lot in said tract without the written permission of said first party, its successors or assigns, and of owners of all adjoining or abutting property, which said written permission must be duly recorded with the County Recorder of Los Angeles County before it shall be effective.

"E". That there is reserved to said first party for the benefit of all property owners in said tract the right to permit any public utility company or municipality to erect and maintain along, over or under the rear seven and one-half feet of said premises, poles and wires, pipes and conduits for the purpose of conveying electricity, water, gas, sewer and telephone lines.

"F". That no gravel or top soil shall ever be removed or sold from said premises in commercial quantities, but that if deemed by said seller desirable for the improvement and beautification of said tract, it may grade any street or lot in said tract by removing from or placing upon the same earth so as to bring the same to such grade as shall in seller's judgment conform to the general plan of said tract.

"G". That no lot in said tract nor any part thereof shall ever at any time be used or occupied or permitted to be used or occupied or leased or rented to any person not entirely of the White or Caucasian race, except that persons of other races may occupy or use such portions of said premises as may be necessary in the proper discharge of duties as household servants actually employed by the family entitled to occupy said premises; and except that any of said business lots may be rented, leased or sublet,

in whole or in part, to persons of other races for the purpose only of establishing or conducting a legitimate business upon any of said business lots, and provided that such persons of such other races shall never at any time use or occupy any of said business lots to any extent whatever for residence purposes.

"H". That no part of said premises shall be used for the manufacture or sale of intoxicating liquors.

"I". Provided that each and every one of the conditions, restrictions, reservations and easements herein contained as above set forth shall be perpetual and binding forever upon the parties hereto, their heirs, executors, administrators, successors or assigns, except only paragraphs "A" to "D", both inclusive, hereof, which shall in all respects terminate and end and be of no further effect, either legal or equitable, on and after January 1, 1953.

PROVIDED, FURTHER, That a breach of any of the foregoing conditions, either directly, or under some evasive guise, shall cause said premises to revert to the grantor herein, its successors or assigns, each of whom respectively shall have the right of immediate re-entry upon said premises, in the event of any such breach; and, as to the owner of any other lot in said tract the foregoing restrictions and conditions shall operate as covenants running with the land, and the breach of any such covenant, or the continuance of any such breach may be enjoined, abated or remedied by appropriate proceedings by the grantor herein, its successors or assigns (including contract purchasers of other lots in said tract), or by any such owners, their heirs, devisees, executors, administrators, successors or assigns, but by no other person. No

delay of grantor or said owners in exercising their rights hereunder in case of such breach shall be deemed as a waiver of such rights.

PROVIDED, ALSO, That a breach of any of the foregoing conditions, or any re-entry by reason of such breach, shall not defeat or render invalid the lien of any Mortgage or Deed of Trust made in good faith, and for value, as to said premises or any part thereof; but said conditions shall be binding upon and effective against any owner of said premises whose title thereto is acquired, by foreclosure, trustee's sale, purchase, devise, inheritance or otherwise.

The Buyer agrees not to transfer or assign this contract, or any interest herein, without the written consent of the Seller first having been secured to such proposed assignment, and agrees to pay the Seller the usual fee of Two Dollars Fifty Cents ($2.50) for each assignment, together with all interest and payments due to date of such consent. No such assignment shall be valid or effective as against said Seller until such written consent of Seller is endorsed on Buyer's duplicate original hereof.

It is understood and agreed and it is a part of the consideration hereof, that this contract shall not be recorded, and in the event that the same is recorded Buyer agrees to pay all charges of said Title Company for Certificate or Guarantee of Title occasioned by such recording.

The term "Buyer," wherever used in this Agreement, shall include the plural as well as the singular number,

and the masculine and feminine, as well as the neuter gender.

Each and all of the various rights, powers, options and remedies of said Seller contained in this agreement shall be construed as cumulative and not one of them as exclusive of any other or others or as exclusive of any remedy or remedies allowed by law.

Each and every one of the conditions, restrictions, covenants and agreements contained herein shall inure to the benefit of and/or bind (as the case may be) the heirs, executors, administrators, devisees, successors, and assigns of the respective parties hereto.

IN WITNESS WHEREOF, the said Seller and said Buyer have executed this Agreement in duplicate the day and year first above written.

THE PACIFIC NATIONAL BANK OF LOS ANGELES

Attest.....

Vice-President.

Attest.....

Assistant Trust Officer

Seller

.....

.....

Buyer

ASSIGNMENT

FOR VALUE RECEIVED I do hereby grant and assign to.....; the foregoing contract, of which I hereby certify I am the true and lawful owner, and all my right, title and interest in and to the property therein described, this.....day of ....., 192.....

.....

.....

ASSIGNEE'S ACCEPTANCE

The undersigned assignee named in the foregoing assignment hereby accepts said assignment, and assumes and agrees to perform all the terms, covenants and conditions thereof, and promises to pay the balance of said purchase price as therein provided, this.....day of ....., 192.....

Signature.....

Signature.....

Address.....

OWNER'S CONSENT

We hereby consent to the foregoing assignment, without obligation on us to its validity, this.....day of ....., 192.....

THE PACIFIC NATIONAL BANK OF LOS ANGELES

By.....

Vice-President

Attest .....

Assistant Trust Officer

TESTIMONY OF E. C. MAEDER FOR PLAINTIFF

E. C. Maeder, called as a witness on behalf of the Plaintiff, being first duly sworn, testified as follows:

DIRECT EXAMINATION

My name is E. C. Maeder. I am the Secretary of Pacific National Company. Plaintiff owns the claim against the Government for the refund of 1928 Federal Corporate income taxes in the amount of $9,669.89.

CROSS EXAMINATION

I refer to the claim for refund filed about April 1, 1932. I became Secretary of the Corporation in April, 1932.

REDIRECT EXAMINATION

I am somewhat familiar with the claim for refund of Federal taxes for 1928, filed by Plaintiff on or about February 26, 1931. The Plaintiff has not, to my knowledge, assigned any interest in the 1928 claim, but still owns both claims.

RECROSS EXAMINATION

I have gone over the records of Plaintiff and there have been no assignments of income tax refunds. There have been no such assignments since April, 1932. There was no assignment of any claim for refund.

REDIRECT EXAMINATION

I have not gone back over the entire records of Plaintiff since its inception. I am not familiar with the assignment made by Plaintiff of various assets to Transamerica Corporation.

(Testimony of F. W. Shelton)

RECROSS EXAMINATION

There were some assignments of assets on December 23, 1931, when Plaintiff made a settlement with the Bank of America. That assignment did not carry with it the claim for refund of income taxes filed about the 25th day of February, 1931. I checked that particular account and there was no assignment of any claim for refund of taxes.

TESTIMONY OF F. W. SHELTON
FOR PLAINTIFF

F W. Shelton, called as a witness on behalf of the Plaintiff, being first duly sworn, testified as follows:

DIRECT EXAMINATION

My name is F. W. Shelton. I was secretary of the Pacific National Company from about 1926 to 1930. As secretary I had charge of its books. I kept the books on the cash basis. I prepared the 1928 income tax return of the Plaintiff.

My experience in income tax matters was limited to the preparation of the return of the Plaintiff for several years. In 1928 I was 26 years old. I did not have any advice, assistance or instruction from any of the Company officials in preparing the 1928 return. I did not have any advice, instruction or information from outside income tax experts, or other outsiders.

In the 1928 return of Plaintiff, I included $137,007.17 as being income of Trust No. P. T. 46, Pacific National Bank, Trustee. A copy of the 1928 Return was introduced in evidence as Plaintiff's Exhibit No. 1.

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(Testimony of F. W. Shelton)

The Company purchased a piece of property at Culver City. The land was conveyed to the Pacific National Bank as Trustee and subdivided and streets laid out. The cost of the tract was allocated over the lots on the basis of expected selling prices of the lots. The cost of the improvements was allocated over the lots by the same method. When the lot was sold the profit was arrived at by deducting from the selling price the cost of the lot, the improvement and the commissions. In computing the income of the Trust for 1928, I treated the sales contracts as being equivalent to cash. Most of the contracts were sold on the basis of 25 per cent down and the balance over a period of time.

I did not know that the 1928 Revenue Act permitted sales to be reported on the installment basis when 25 per cent of the selling price was received in the year of sale. I understood that the sale had to be treated as a cash sale or a completed sale. I got this impression from looking at some Regulation book.

I did not know that the law permitted reporting sales contracts at their fair market value.

I did not know that where the down payment exceeded 40 per cent the law permitted the collections to be treated as return of capital until the cost had all been collected, and to treat the subsequent collections as all income.

In calculating the income of the Trust for 1928, I included the sales that were made in 1927.

The existence of net loss to Plaintiff for previous years, amounting to about $35,000, and which I deducted in the

(Testimony of F. W. Shelton)

1928 return, did not determine the method which I used in reporting the income of this Trust in the 1928 return.

Q Mr. Shelton, are you familiar with the sales methods used by Frank J. Brick in selling the lots in trust P. T. 46?

MR HARPOLE: Objected to as immaterial and outside the issues in the claim for refund.

MR. WILSON: My purpose, your Honor, is to show again that this taxpayer should be relieved from an election by reason of the fact that the method of reporting did not clearly reflect income. I want to show there were sales made, with very large commissions, and at high-pressure methods, and it is not good accounting to treat those contracts as the cash value equal to the face value.

THE COURT: Isn't Mr. Brick here?

MR. WILSON: We haven't him. This witness is familiar with his methods of doing business.

MR. HARPOLE: Your Honor, I believe this evidence is not proper under the theory that the contracts are not of their face value. The Supreme Court of California laid down a rule in one of the cases, and the reason for that rule was to prevent going into the details of what such sales agent said, and all the surrounding circumstances that can only be asked on cross examination.

THE COURT: I think I know the rule that you have in mind. But I want to know now whether the objection goes to this as being secondary proof, when there is better.

MR. HARPOLE: No, I did not have that in mind.

THE COURT: Is it the Government's position that on this line of evidence the taxpayer must introduce evi-

(Testimony of F. W. Shelton)

dence to show that the land sold had certain market value?

MR. HARPOLE: I don't believe the land value has any place in here at all, other than perhaps if we go to the place where we are considering the security behind the contracts. The contracts are the proper thing to be valued, if anything, and I think this is immaterial.

THE COURT: Objection overruled.

MR. HARPOLE: Exception.

(Question read by the Reporter.)

THE WITNESS: He generally used what we call the lunch and lecture methods. He had a lecture hall out there and gave lectures and gave lunches each day.

BY MR. WILSON:

Q Do you know if Mr. Brick had a large force of salesmen?

A I don't know how many he had.

Q Do you know if the asking price of those lots was increased from time to time during Mr. Brick's campaign?

A On some of the lots, yes.

CROSS EXAMINATION

The Pacific National Company was originally incorporated with a capital stock of $2,000,000. It was more or less of a holding company for stocks of various banks. It increased its capitalization in 1928 I believe, to $4,000,000.

I was originally employed by the Pacific National Bank. I started as a bookkeeper there in 1924 and was with the

(Testimony of F. W. Shelton).

Bank until the time of its sale to the Bank of America. The Pacific National Company was formed as a holding company for stocks of Pacific National Bank and several other Banks, and the officers of the Company were officers of the Bank. Prior to accepting the position as bookkeeper with the Pacific National Bank, I was a teller for about two years with the California Bank. I had a high school education.

As Secretary of Pacific National Company, I kept their records. I prepared the 1926 and 1927 income tax returns. I was familiar with the rule or regulation of the Bureau of Internal Revenue that returns should be prepared and income reported on the basis of the method used in keeping the books of the reporting company. The 1928 return of Plaintiff was made from its books.

On August 20, 1928, I set up on the books of Plaintiff the cost of the property in the Trust less the lots that had been sold to date. I increased the cost on the books of Plaintiff for assessments of gas and water improvements.

The general ledger of Pacific National Company, for 1928, shows a gross profit on the sale of real estate of $306,181.69; commissions paid of $182,711.49; expense on Speedway property of $4,044.56. These figures related to the activities of Trust No. P. T. 46. The item of Three Hundred and odd Thousand Dollars is the proceeds from the property in Trust No. P. T. 46. The Plaintiff, during the year 1928, carried that entry in its own profit and loss account in its regular set of books, and the 1928 return was prepared from those books.

REDIRECT EXAMINATION

The Pacific National Company did not, in 1928, receive any cash from Trust P. T. 46. In fact the Pacific National Company put some money, about $50,000, into the Trust to enable the Trust to reduce its mortgage.

The Trustee kept books of the activities of Trust No. P T. 46. The Trustee gave the Pacific National Company data on the activities of the Trust. From this data I made the entries in the Plaintiff's ledger.

I know Walter G. L. Smith. I recognize his signature on the document now being shown to me. He was connected with the Pacific National Company at one time. That is his signature.

MR. WILSON: I would like to offer this in evidence and have it marked.

THE CLERK: Plaintiff's Exhibit 2 for identification.

MR. HARPOLE: I object to the offer of Exhibit 2 in evidence for the reason it is immaterial. The transaction took place long subsequent to the taxable year involved.

MR. WILSON: That has a bearing on the case in two respects. There was an assignment of many assets of the Plaintiff to the Transamerica Corporation, but it expressly excludes from the assignment this claim for refund Furthermore, it is part of the evidence showing that the Plaintiff lost its entire investment in the beneficial interest of this trust, which I think has some bearing on the case.

THE COURT: The instrument purports to transfer and assign, in subdivision F, of paragraph 1: "The bene-

(Testimony of F. W. Shelton)

ficial interest of first party in two trusts set forth and described in Schedule 5 attached hereto and expressly made a part hereof." Schedule 5 sets forth two trusts known as P. T. 10 and S.1542.

MR. WILSON: Your Honor, that can be explained by testimony to show that the Title Guarantee & Trust Company became the trustee of this trust, and gave the latter number to it at that time.

THE COURT: Objection overruled.

MR. HARPOLE: Please note an exception.

THE CLERK: Plaintiff's Exhibit 2 in evidence.

(Whereupon the document referred to was received in evidence and marked "Plaintiff's Exhibit No. 2.")

The Pacific National Company kept a record of the costs, sales price, expense and gross profit of the land included in Trust No. P. T. 46. I made the 1928 return of Plaintiff entirely from the records of Plaintiff.

The Title Guarantee & Trust Company subsequently became the Trustee of Trust P. T. 46.

On Plaintiff's books all of the accounts dealing with the cash or property or activities of Trust P. T. 46, refer to the fact that the items were Trust items.

I set up the books for Plaintiff. I had no directions about setting them up. I used my own knowledge and experience in setting up the various accounts. I had no instructions from the officers or directors of the Bank

(Testimony of C. W. Sanders)

during the progress of the keeping of the general ledger. I had no consultant advise in the preparation of the 1928 return. I had no advice from the officers of the Bank or any other persons interested in the Trust, relative to the preparation of the 1928 return.

RECROSS EXAMINATION

Either the Pacific National Company or the Trustee employed Mr. Elwell and Mr. Brick to sell lots from the subdivision Trust. The commissions were paid out of the Trust. The accounts of the Plaintiff show the commissions paid by the Trustee.

TESTIMONY OF C. W. SANDERS FOR PLAINTIFF

C. W. Sanders, called as a witness on behalf of the Plaintiff, being first duly sworn, testified as follows:

DIRECT EXAMINATION

My name is C. W. Sanders. I am employed by the Security First National Bank of Los Angeles. I am head of the Income Tax Division of that Bank. I have been with the Bank in that capacity since 1921; that is the Security Trust & Savings Bank. The Security First National Bank at one time was Trustee for about 500 subdivision Trusts. In connection with my work I handled a good deal of the tax work for those subdivisions. I had entire charge of that work.

Ordinarily, the Trustee refused to sign contracts of employment with the sales agent. Such contracts were usually signed by the beneficiaries or a committee of the beneficiaries.

(Testimony of William H. Elwell)

CROSS EXAMINATION

I have never been employed by any other Bank or Trust Company of the City of Los Angeles. I have never seen any contracts for the employment of sales agents for subdivision Trusts, for any other Trusts than those handled by the Security First National Bank of Los Angeles. It was the practice of that Bank to require the sales agency contracts to be executed by the beneficiaries.

TESTIMONY OF WILLIAM H. ELWELL FOR PLAINTIFF

William H. Elwell, called as a witness on behalf of the Plaintiff, being first duly sworn, testified as follows:

DIRECT EXAMINATION

My name is William H. Elwell. I am engaged in the real estate business. I have been engaged in that business twenty-seven years; around Los Angeles all of that time. I have had experience in subdivisions of real property.

I had some contact with the Culver City Park Tract known as Trust No. P. T. 46, Pacific National Bank, Trustee.

One of the officials of the Pacific National Bank asked me to make an estimate of what the Culver City Park Tract could be sold for. He gave me the dimensions of the property and I drew a tentative map and set prices on it which would exceed a certain amount of money which he said the Bank wanted to get. I made this tentative map of the prices; I had sign boards painted with

some advertising matter on them, and a sales force partly organized. The Bank official then informed me that he had made a mistake, that some of the property he supposed was included in the subdivision really was leased land and belonged to another party; that the Bank's land did not include the entire race track as he had supposed.

The Bank wanted me to raise the prices so that it could get the same amount of money out of the reduced area as it had figured on getting out of the larger area. I did not care about going on with the matter any further as I did not think the lots would sell at higher figures than I had originally estimated and it would not make a profitable venture for me. The Bank had a loan and had to have enough money to pay this off with, of course, costs of sale.

My first schedule of prices for residential lots was eight or nine hundred dollars, or a thousand dollars per lot. The business lots I priced at $75.00 a foot on the main boulevard.

I wrote a letter to the Pacific National Bank outlining a sales campaign and commissions payable. I was employed to conduct the campaign along the lines of the letter. (The letter was introduced in evidence as Plaintiff's Exhibit No. 3).

I agreed to increase the sales prices of the lots so as to return to the Bank the same amount of money that they had hoped to get from a larger area. I attempted

to sell lots under that higher sales schedule. I did sell a few lots.

Frank J. Brick heard that I did not care about going ahead with the subdivision and asked the Bank for the sales agency. The Bank asked me if I thought he would be a good man and I said I thought perhaps he could sell the lots by using high pressure methods, such as the lunch and lecture system.

The Bank then agreed to employ Mr. Brick and to give me a one per cent overriding commission on sales made by Mr. Brick.

Mr. Brick gave free lunches and had lectures delivered to prospective lot buyers. The lecturers elaborated upon conditions; sometimes, in my opinion, they were not truthful. Mr. Brick was reported to have used high pressure closers.

I received about $1,600, all told, as overriding commissions on Mr. Brick's sales. Mr. Brick was to receive all of his commissions and I was to get the last one per cent. The $1,600 I received did not represent one per cent of the total sales made during the term of his contract. So many buyers canceled their purchase contracts and failed to make their payments that I did not get as much of the overriding commissions as was due me.

Mr. Brick sold the lots for prices which were two or three times as high as the prices I thought the lots would sell for.

I do not think that the contracts with buyers were worth their face value. I think that the contracts had a fair

market value of one-third to one-half of the selling prices. The fair market value of the contracts at the time they were executed would, of course, be reduced by the cash payments made by the buyers.

I am not interested in the outcome of this case, either by virtue of any contractual relationship that would be affected by a decision in this case, or otherwise.

The Plaintiff and Defendant, through their respective counsel, entered into the following oral stipulation which was accepted by the Court:

MR. WILSON: If your Honor please, we have a verbal stipulation. Will you assist me in dictating this, Mr. Harpole?

MR. HARPOLE: May it please the Court, the defense is agreeable to a stipulation to the effect that should the Court decide either that the plaintiff is entitled to change its method of computing income from the completed sale basis to the installment or deferred payment sale basis, or it should be decided that the trust should have reported the income on the basis of an association taxable as a corporation, and should have filed a separate return as a corporation instead of as a trust, that there would be some amount of refund due. They have reserved the right to endeavor to compute that without taking time now.

THE COURT: Yes.

MR. HARPOLE: And further, that if a change of basis was granted, that no income would escape taxation in subsequent years by reason of the Statute of limitations; I do not wish the stipulation to be taken as abandoning our contentions as to the right to change the basis.

TESTIMONY OF HARRY KAHAN FOR PLAINTIFF

Harry Kahan, called as a witness on behalf of the Plaintiff, being first duly sworn, testified as follows:

DIRECT EXAMINATION

My name is Harry Kahan. I am a Certified Public Accountant under the laws of California. About 1930, I audited the books of Pacific National Company. I prepared the Claim for Refund for Plaintiff which was filed February 26, 1931.

The books of the Pacific National Company, which were kept by Mr. Shelton, were kept strictly on the cash basis in a method which is used mostly by Banks. Entries were made in a great number of cases direct to the ledger without having intermediate steps.

I compiled from the records of the Trustee of Trust No. P. T. 46, Pacific National Bank, Trustee, for the year 1928, a summary of the condition of the contracts for the sale of lots of the Trust.

I examined the terms of the contracts of sale and the payments under those contracts, and this is the finding as to those that were in good standing and paid up as of December, 1928, and those that were delinquent at that date.

I believe that Exhibit 9, which I have prepared, is a true and correct summary of the condition of the contracts at the end of 1928.

The Plaintiff offered the Exhibit in evidence. The Defendant objected on the ground that the Exhibit was wholly immaterial and not pertinent to any issue in this case, and not based upon any Claim for Refund filed

(Testimony of Harry Kahan)

within the statutory period, and on the further ground that it was not the best evidence; that the books were the best evidence. Further, that the Exhibit does not have anything to do with the corporation which has elected to report on the completed sales basis; the time for changing that basis has expired. The Court overruled the objection and the Defendant took an exception. The summary was introduced into evidence as Plaintiff's Exhibit No. 9.

I prepared, or had prepared in my office under my supervision, a summary of information taken from the books and records of Trust P. T. 46, and I believe that this is a true and correct summary of the facts found in those books. The Witness referred to Plaintiff's Exhibit No. 10. Plaintiff offered the Exhibit No. 10 in evidence; the Defendant objected and the following colloquy occurred:

MR. HARPOLE: May I enter and reiterate an objection? I am running a risk of being tedious in making the same objection over and over again as to immateriality, but I call attention to the fact that there is no claim for refund on file asserting that the contracts were not worth face value. That was not made an issue in the two refund claims. The first refund claim, which is attached to the amended complaint, made an issue of the question of changing from the installment to the completed sale basis, and the second one made an issue of the question of changing from a trust to an association basis.

MR. WILSON: Of course, your Honor, I think that it goes to the question of alleviating circumstances that will relieve a taxpayer from the election that the various courts have held are good grounds for relieving from that

(Testimony of Harry Kahan)

election. These are expert accountants that prepared this, and I thought it would be more authentic if they did it.

THE COURT: I think we will receive the evidence. I will overrule the objection tentatively, subject to the same reservation that was made at the beginning.

THE CLERK: Plaintiff's Exhibit 10.

MR. HARPOLE: Exception.

(Whereupon the document referred to was received in evidence and marked "Plaintiff's Exhibit No. 10.").

BY MR. WILSON:

Q Mr. Kahan, do you recognize these papers?

A Yes, I do.

Q What are they?

A Photostatic copies of fiduciary income tax returns for the year 1928 for Culver City Speedway Trust No. 46, Pacific National Bank of Los Angeles, Trustee, under its private trust No. 46, Bank of America successor in interest.

Q And the other one?

A This is a similar photostatic copy, only for the year 1927.

MR. WILSON: It has been stipulated, your Honor, that the originals of these were filed with the Collector on January 3, 1935, and I would like to offer these in evidence.

MR. HARPOLE: The exhibits are objected to, your Honor, as being immaterial, particularly that they relate to a transaction that took place long after this action was filed in court, and it was at issue originally. Further than

(Testimony of Harry Kahan)

that, there are—these are immaterial for the reason an election was made when the original return was filed by the plaintiff, reporting the income from the trust as its own.

MR. WILSON: I think they are material, your Honor, for the reason that under the law the trustee of every trust has an obligation to keep books and file returns, and are permitted to choose their own methods of keeping books and filing their returns, and the trustee of this trust never filed returns for these two years until 1935, and I think it is admissible to show what type of return they filed at that time.

MR. HARPOLE: That is one of the questions before your Honor in this case, as to whether the trustee has the right to elect to file a return of that type.

THE COURT: I don't see how the filing of a return after the issue is joined in this case throws any light on the matter here. If there had been any returns filed before the issue was joined, then probably it would be admissible; it might be helpful in the solution of the problem. How can what they did after the suit was at issue help us?

MR. WILSON: Of course, your Honor, the election that the Government argues is on the seller of the real estate; that was the trustee; the plaintiff did not sell the real estate and there was no election with respect to the way it shall treat its share of the distribution of the trust. I don't think any election could have been made by or for this trust until it made it itself.

THE COURT: It is your contention, then, or will be, that these two exhibits which you are now offering constitute the election?

MR. WILSON: Yes, your Honor.

(Testimony of Harry Kahan)

THE COURT: I am not saying that that finally will be sustained or will not be sustained, but the objection will be overruled.

MR. HARPOLE: Exception.

THE CLERK: Plaintiff's Exhibit 11.

(Whereupon the documents referred to were received in evidence and marked "Plaintiff's Exhibit No. 11.")

I am familiar with a contract that was made by Plaintiff in 1929 to sell stock it owned in the Pacific National Bank to Transamerica Corporation. I have recently looked in my office, and in the Plaintiff's office, for that contract, or a copy of it, but I have not been able to find it.

By the terms of that contract the Bank of America agreed to buy the stock of the Pacific National Bank which was owned by the Pacific National Company. The Pacific National Company at that time owned over 80 percent of the stock of the Pacific National Bank. The Bank of America, at the same time, made agreements with the minority stockholders to purchase their stock of the Pacific National Bank, and to take over the Pacific National Bank with a guarantee by Plaintiff of all the assets of the Pacific National Bank. In return the Bank of America gave some 65,000 shares of Transamerica stock to Plaintiff, which stock was to be held in escrow until such time as the guarantee would be satisfied. The guarantee period was for one year, and at the end of the year there was an extension made of a year.

I am familiar with Plaintiff's Exhibit No. 2, being a contract dated December 23, 1931, between Plaintiff and Transamerica Corporation. Under this contract the Plain-

tiff assigned to Transamerica Corporation, under the guarantee contract made in 1929, many of the assets of Plaintiff; among other things, it transferred to Transamerica Corporation Plaintiff's beneficial interest in Trust P. T. 46. At that time, December 23, 1931, there was still an encumbrance on the property of Trust No. P. T. 46. This encumbrance exceeded $100,000.

As of December 31, 1928, there was owing to Pacific National Bank, as Trustee of Trust No. P. T. 46, by buyers of lots who made down payments of less than 40 per cent of the selling price, $489,974.

CROSS EXAMINATION

In my practice as a Certified Public Accountant, I have frequent occasion to file claims for refund of Federal taxes. I am familiar with Form 843, form for refund claims. Those forms are filed with the Collector of Internal Revenue in the District in which the return has been filed. After the claim is filed, a Revenue Agent ordinarily investigates the claim and either recommends the allowance or rejection of the claim.

The Plaintiff filed a claim for refund of 1928 taxes with the Collector of Internal Revenue, about February 21, 1931. I prepared the claim. That claim advanced the contention that the Plaintiff should be permitted to change its method of reporting income from lot sales from the completed transaction to the installment basis.

An additional or amended claim was filed by the Plaintiff for the same year. Mr. Wilson's office prepared and filed the amended claim.

Plaintiff was the sole beneficiary of Trust No. P. T. 46, Pacific National Bank, Trustee, during 1928.

(Testimony of Harry Kahan)

During 1928, the Plaintiff owned 80 per cent or more of the stock of Pacific National Bank, the Trustee of Trust No. P. T. 46.

Q Now, let us turn to the relationship between this Plaintiff with the Pacific National Bank, Trustee of P. T. 46 during the year 1928 and subsequently; the Plaintiff, Pacific National Company, was the sole beneficiary of trust P. T. 46, of which the Pacific National Bank was trustee, was it not?

A Yes, it held the entire beneficial interest.

Q And it also, to all practical purposes, owned the trustee of trust P. T. 46?

MR. WILSON: Objected to as a conclusion of the witness.

MR. HARPOLE: Withdraw the question.

Q During the year 1928 it is a fact, is it not, that the Pacific National Company owned eighty per cent or more of the stock of the Pacific National Bank?

A That is right.

Q The trustee of P. T. 46?

A Yes.

Q Then it is a fact that this Plaintiff, Pacific National Company, in 1928 was the sole beneficiary of Trust P. T. 46, and was the owner of at least eighty per cent of the stock of the trustee of that trust?

A That is right.

(Testimony of Harry Kahan)

MR. HARPOLE: For the purpose of the record, I wish to move to strike plaintiff's exhibits 4 to 11 inclusive, on the ground that they are immaterial and irrelevant.

THE COURT: The motion is denied with the reservation of vacating the ruling later.

MR. HARPOLE: May an exception be reserved in the event of a final unfavorable ruling?

THE COURT: It may.

MR. HARPOLE: That is all.

(Witness excused.)

MR. WILSON: I would like to offer in evidence a letter from the Treasury Department, addressed to a member of my firm, dated July 17, 1928.

MR. HARPOLE: That is objected to as immaterial; it is the case of another taxpayer entirely, and simply corresponds about another tax problem.

MR. WILSON: Your Honor, I offer that as an unpublished ruling of the Commissioner, supporting our theory that no one but a trustee can file a return which will bind the trustee, and if anyone attempts or purports to do so, the trustee can file a return and the Commissioner will accept it.

MR. HARPOLE: The ruling is not purported to be signed by the Commissioner, but by a deputy, and in the

absence of some explanation I don't think the deputy can publish a binding ruling.

MR. WILSON: I think this is one of the cases which recognizes that where the Commissioner is absent, a deputy might act.

THE COURT: Objection overruled.

MR. HARPOLE: Exception.

THE CLERK: Plaintiff's Exhibit 12.

(Whereupon the document referred to was received in evidence and marked "Plaintiff's Exhibit No. 12.")

MR. WILSON: Plaintiff rests, your Honor.

MR. HARPOLE: At this time I wish to file a motion for judgment, written motion in behalf of the defendant.

(Handing same to the Court.)

THE COURT: The motion for judgment at this time is denied, without prejudice.

MR. HARPOLE: May I reserve an exception to the denial, in the event of a final adverse ruling?

THE COURT: Yes.

MR. HARPOLE: The defendant rests, and requests the Court for special findings of facts and conclusions of law.

MR. WILSON: Plaintiff moves for judgment, and special findings of fact also, your Honor.

EXHIBIT 1

Form 1120 Page 1 of Return

U. S. Internal Revenue
(Auditor's Stamp)

CORPORATION INCOME TAX RETURN
For Calendar Year 1928

File This Return with the Collector of Internal Revenue for Your District on or Before March 15, 1929

PRINT PLAINLY CORPORATION'S NAME AND BUSINESS ADDRESS

PACIFIC NATIONAL COMPANY
(Name)

855 SO. HILL ST
(Street and number)

LOS ANGELES, CALIF.
(Post office and State)

Date of Incorporation 1925

Under the Laws of what State or Country California

Kind of Business Investment Holding Co.

Is This a Consolidated Return of Two or More Corporations? No

Item and Instruction No.	GROSS INCOME	
* * * * *		
5.	Interest on Bank Deposits Notes, Mortgages, and Corporation Bonds.....	44 893 09

6.	Rents	5 023 11	
	* * * * *		
8.	Profit from Sale of Real Estate, Stocks, Bonds, and Other Capital Assets (From Schedule B)	317 678 55	
9.	Dividends on Stock of Domestic Corporations	90 925 50	
10.	Other Income (including dividends received on stock of foreign corporations). (State nature of income):		
	(a) Commissions	2 715 00	
	(b) Sale of Oil	21 671 40	
11.	Total Income in Items 3 to 10		$482 906 65

DEDUCTIONS

	* * * * *		
15.	Interest	$ 36 157 82	
16.	Taxes (From Schedule E)	6 643 34	
	* * * * *		
19.	Dividends (From Schedule H)	90 925 50	
	* * * * *		
22.	Other Deductions Not Reported Above. (Explain below, or on separate sheet):		
	(a) Salaries and wages. (Not included in Item 2, 12, or 14 above)	14 908 36	
	(b) Net Loss for prior year. (Submit schedule)	35 849 46	

	(c) Commissions paid on sale of Real Estate Subdivision Culver City Cal.....	182 711 49	
	(d) Oil Royalties paid 3315.24 Repairs & expense on Oil Lease $12620.38	15 935 62	
	(e) Stationery, Postage and miscellaneous office expense, legal fees	9 196 76	
	(f) Lighting assessments & Insurance.....	900 96	
23.	Total Deductions in Items 12 to 22.....		$393 229 31
24.	Net Income (Item 11 minus Item 23).....		$ 89 677 34

COMPUTATION OF TAX

25.	Net Income (Item 24 above).....	$ 89 677 34
26.	Less Credit of $3,000 (for a domestic corporation having a net income of less than $25,360)	
27.	Balance (Item 25 minus Item 26).....	$ 89 677 34
28.	Income Tax (12% of Item 27).....	$ 10 761 28
29.	If the Net Income of a Domestic Corporation is less than $25,360, enter the amount in excess of $25,000.....	
30.	Total Tax (Item 28 plus Item 29).....	$ 10 761 28

* * * * *

33.	Balance of Tax (Item 30 minus Items 31 and 32)	$ 10 761 28

An amended return must be marked "Amended" at top of return

Checks and drafts will be accepted only if payable at par

SCHEDULE K—BALANCE SHEETS

(See Instruction 43)

Items	Beginning of Taxable Year Amount	Beginning of Taxable Year Total	End of Taxable Year Amount	End of Taxable Year Total
ASSETS				
1. Cash		$ 18 269 96		$ 77 990 84
2. Notes receivable		114 745 27		903 361 47
* * * * *				
8. Capital assets: Land		166 599 55		792 485 01
* * * * *				
11. Other assets (describe fully): Investment in Stocks	$2 113 070 76		$4 188 799 32	
		2 113 070 76		4 188 799 32
12. Total Assets		$2 412 685 54		$5 962 636 64
LIABILITIES				
13. Notes payable		$ 559 175 00		$ 996 378 80
* * * * *				
16. Other liabilities (describe fully): Real Estate Mortgages & Contracts Payable			285 655 00	$ 285 655 00
17. Capital stock: Preferred stock (less stock in treasury)	$		$	
Common stock (less stock in treasury)	1 717 600 00	1 717 600 00	4 000 000 00	4 000 000 00
18. Surplus	$ 171 760 00		$ 600 000 00	
19. Undivided profits	35 849 46	135 910 54	80 602 84	680 602 84
20. Total Liabilities		$2 412 685 54		$5 962 636 64

Remarks: Balance of original authorized capital of 2,000,000.00 paid in during year plus $10.00 per share for surplus. Authorized capital increased to $4,000,000.00 which was paid in during year 1928 plus 20.00 per share for surplus.

SCHEDULE #1

Loss for Prior Year

1925

Profit from Sale of Stock	$ 31.50	
		$ 31.50
Interest	478.78	
Legal Fees	1190.12	
Office Expense	142.10	
Revenue Stamps	211.27	2022.27
Net Loss Year 1925		1990.77

Year 1926

Interest	2331.96	
Rents	1120.95	
Profits on Sale of Stock	12812.77	
Dividends	1500.00	17,765.68
Repairs	238.44	
Interest	19810.17	
Taxes	770.37	
Insurance and Other Expenses	1021.74	
Advertising	4703.61	
Stationery	930.01	27 474.34
Net Loss Year 1926		9708.66

Year 1927

Interest Earned	7662.03	
Rents	5319.31	

Dividends	4411.10	
Fees	5.00	17 397.44
Repairs	202.65	
Interest paid	38579.48	
Taxes	218.50	
Street Lighting Assessments	705.79	
Stationery Etc.	1202.90	
Insurance	638.15	41 547.47
Net Loss Year 1927		24 150.03

Total Loss Three Years	1925	$ 1990.77
	1926	9708.66
	1927	24150.03
		35849.46

* * * * * * * * *

SCHEDULE B—PROFIT FROM SALE OF REAL ESTATE, STOCKS, BONDS, ETC. (See Instruction 8)

1. Kind of Property	8. Net Profit (Enter as Item 8)
Real Estate Subdivision	
Net difference between Cost and Selling Price	$308 800 45
Stocks	
" " " " " "	8 878 10
Total	$317 678 55

* * * * * * * * *

SCHEDULE E—TAXES PAID (See Instruction 16)

1. Items	2. Amount (Enter as Item 16)
State Corporation Tax	$ 243.00
City & County Los Angeles	6 400 34
	$6 643 34

* * * * * * * * *

SCHEDULE H—DIVIDENDS DEDUCTIBLE
(See Instruction 19)

1. Name of Corporation	Amount of Dividends 2. Domestic
First National Bank, South Pasadena	$ 100 00
First National Bank, Phoenix, Ariz.	1 300 00
Florence National Bank, Florence, Calif.	1 488 00
Los Angeles Creamery Co.	66 50
Graham National Bank, Graham, Calif.	1 203 00
Pacific National Bldg. Corpn.	86 768 00
Total	$90 925.50

* * * * * * * * *

SCHEDULE L—RECONCILIATION OF NET INCOME AND ANALYSIS OF CHANGES IN SURPLUS

1. Net income from Item 24, page 1 of the return $89 677 34

2. Nontaxable income:

* * * * * * * * *

(d) Dividends deductible under Section 23(p) of the Revenue Act of 1928.... 90 925 50

* * * * * * * * *

(f) Other items of nontaxable income (to be detailed):	
(1)	
(2) Net Loss prior years	35 849 46
* * * * * * * * *	
5. Total of Lines 1 to 4, inclusive	$216 452 30
* * * * * * * * *	
7. Net profit for year, as shown by books, before any adjustments are made therein (Line 5 minus Line 6)	$216 452 30
8. Surplus and undivided profits as shown by balance sheet at close of preceding taxable year	135 910 54
9. Other credits to surplus (to be detailed):	
(a) Surplus paid in	428 240 00
10. Total of Lines 7 to 9, inclusive	$780 602 84
11. Total from Line 17	100 000 00
12. Surplus and undivided profits as shown by balance sheet at close of taxable year (Line 10 minus Line 11)	$680 602 84
* * * * * * * * *	
15. Dividends paid during the taxable year (state whether paid in cash, stock of the corporation, or other property):	
(a) Date paid Oct. 1 1928 Character Cash	40 000 00
(b) Date paid Jan. 1 1929 Character Cash	60 000 00
* * * * * * * * *	
17. Total of Lines 15 and 16	$100 000 00

QUESTIONS

KIND OF BUSINESS

1. By means of the key letters given below, identify the corporation's main income-producing activity with one of the general classes, and follow this by a special description of the business sufficient to give the information called for under each general class.

* * * * * * * * *

H.—Finance, including banking, real estate, insurance.

* * * * * * * * *

3. Answers:

(a) General class (use key letter designation) H

(b) Main income-producing business (give specifically the information called for under each key letter, also whether acting as principal, or as agent on commission; state if inactive or in liquidation) Sale of Real Estate and dividends from stocks held for investment

AFFILIATIONS WITH OTHER CORPORATIONS

See Instruction 38

4. Does the corporation own 95 per cent or more of the outstanding capital stock of another domestic corporation or of other corporations? Yes

5. Is 95 per cent or more of your outstanding capital stock owned by another corporation? No

6. Is 95 per cent or more of your outstanding capital stock as well as 95 per cent or more of the outstanding

capital stock of another corporation or of other corporations owned by the same interests? No

7. If the answer to questions 4, 5, and 6, or to any of them, is "yes," answer the following:

(a) Did the corporation file Forms 851, 852, 853, and 853A for the taxable year 1924 or subsequent taxable years? Yes If the answer to this question is "yes," these forms will not be required, except under the circumstances described in question (b). If the answer to this question is "no," and the answer to questions 4, 5, and 6, or to any of them, is "yes," procure from the Collector of Internal Revenue for your district Forms 851, 852, 853, and 853A, Affiliations Schedules 1, 2, 3, and 4, which shall be filled in and filed as a part of this return. If the answer to this question is "no," question (b) need not be answered.

(b) Did exactly the same conditions, as are set out in the Affiliations Schedules filed for 1927 or prior years, obtain during the entire taxable year 1928?..... If the answer to this question is "no," a statement, setting forth the particulars in which the situation has changed, should be attached to and made a part of this return. If there have been any changes in stockholdings, a complete schedule of such changes should be submitted on Form 853, Affiliations Schedule 3. If there are companies other than those covered by the Affiliations Schedules for prior years which, applying the tests contained in questions 4, 5, or 6, may have come into the affiliated group since 1927, Forms 851, 852, 853, and 853A, are required for the entire group for the taxable year.

(c) Did the corporation file a consolidated return for the preceding taxable year on a different affiliation basis from this return? No If answer is "yes," a copy of the

Commissioner's letter granting permission to change the basis of filing under Section 142(a) of the Revenue Act of 1928 should be attached to the return.

PREDECESSOR BUSINESS

8. Did the corporation file a return under the same name for the preceding taxable year? Yes Was the corporation in any way an outgrowth, result, continuation, or reorganization of a business or businesses in existence during this or any prior year since December 31, 1917? No If answer is "yes," give name and address of each predecessor business, and the date of the change in entity.

.....

.....

Upon such change were any asset values increased or decreased? No If the answer is "yes," closing balance sheets of old business and opening balance sheets of new business must be furnished.

BASIS OF RETURN

9. Is this return made on the basis of actual receipts and disbursements? Yes If not, describe fully what other basis or method was used in computing net income.

.....

* * * * * * * * *

LIST OF ATTACHED SCHEDULES

11. Enter below a list of all schedules accompanying this return, giving for each a brief title and the schedule

number. The name and address of the corporation should be placed on each separate schedule accompanying the return.

Schedule #1 Loss for Prior Years

The corporation's books are in care of Pacific National Company. Located at 855 So. Hill St. Los Angeles Calif.

AFFIDAVIT

We, the undersigned, president and treasurer of the corporation for which this return is made, being severally duly sworn, each for himself deposes and says that this return, including the accompanying schedules and statements, has been examined by him and is, to the best of his knowledge and belief, a true and complete return made in good faith, for the taxable year as stated, pursuant to the Revenue Act of 1928 and the Regulations issued under authority thereof.

.....

President.

[Corporate Seal] .....

Treasurer.

Sworn to and subscribed before me this.....day of ....., 1929.

[Notarial Seal]

....., ...

(Signature of officer administering oath) (Title)

[Exhibit No. 2 is a written contract between Pacific National Company and Transamerica Corporation, dated December 23, 1931. In contract Pacific National Company assigned to Bank of America National Trust and Savings Association various assets, including 29,188-14/100 shares of the capital stock of Transamerica Corporation, and the beneficial interest of Pacific National Company in the Trust S-1542, Title Guarantee and Trust Company, but excluding the claim of Pacific National Company for a refund of 1928 income taxes. In consideration of said assignment, Transamerica Corporation released Pacific National Company from any further obligation or liability or guarantee which might exist under and by reason of an agreement between the parties dated July 17, 1929 and supplemental and extension agreements.]

EXHIBIT "3"

PACIFIC NATIONAL BANK
Capital $1,000,000.00

LOS ANGELES, CALIFORNIA
August 13, 1927.

Pacific National Bank
Hill at Ninth
Los Angeles, California

Gentlemen:

In reference to sale of the Culver City Park Tract, method that would be employed, etc., I beg to advise you that after a careful study of the situation for several weeks, I find that most of the sub-divisions have practically eliminated the newspaper and radio advertising, and have resorted to the street and house to house canvas for prospects.

The commissions range from 10% to 15% to salesmen, $15 to $20 per week for canvassers and solicitors, with a 2% bonus on sales with the managing solicitor at $20 per week salary and ½% to 1% bonus, and closes with 2% commission.

As manager of your Culver City Park Tract, I would suggest that we employ five solicitors at $15 per week with a bonus of 2% for each sale made the solicitor's prospect. That we employ a manager of solicitors whose duty it will be to put the solicitors out on selected territory, and see that they work diligently; arrange for the qualification of all prospects; arrange to have salesmen bring the prospects to the tract at 11 A. M. and 3 P. M., and assist on the tract with sales in the field. This manager to receive a salary of $200.00 per month and a bonus of ½% to 1% commission on sales. Salesmen to re-

ceive 7½% commission on such sales and 10% commission for sales in case they furnish their own prospects without any expense to us. This is the least expensive method I know of, and eliminates the costly newspaper and radio advertising, and expense of lunch and lecture system, and other high commissions as set forth in this letter. I would suggest, however, that we run a small advertisement in the Culver City paper so that we may obtain the publicity that they have promised us. I would also suggest that we have an attractive pamphlet with an aeroplane photo of the old Speedway showing the close proximity to the center of Culver City, and the many important boulevards in and adjacent to Culver City.

Pacific National Bank
#2

Up to the present time it has been impossible for me to employ a salesman to occupy the office on the corner of Culver Blvd. and Overland Blvd., and run his chances on making sales to prospects who would voluntarily call at this office.

Some tracts are guaranteeing a salesman from $100 to $150 per month to hold down certain corners of their tracts where branch offices are established. It seems to me that we could well afford to employ a salesman for our branch office at a salary of $100 per month guarantee.

It does not seem possible that salesmen in this location could make less than one sale a month. The commission on such a sale would more than pay the guarantee.

Trusting that the above suggestions will meet with your approval, I beg to remain

Respectfully yours,

W. H. ELWELL

Exhibit No. 9

PACIFIC NATIONAL COMPANY LOS ANGELES

PRIVATE TRUST #46

PERTINENT STATISTICS ON CONTRACTS
DECEMBER 31, 1928

STATEMENTS OF PERCENTAGES ON BASIS
OF AMOUNTS AND NUMBER OF ACCOUNTS

	NUMBER		AMOUNT	
	Actual	Percent	Actual	Percent
Paying Accounts	136	60%	$323,762.38	62%
Delinquent Accounts	92	40%	201,674.56	38%
TOTALS	228	100%	$525,436.94	100%
Cancelled Accounts	16	6%	$ 35,274.51	6 3/5%
Cash Sales	13	5 3/5%	$ 41,144.25	7 4/5%

Number percentages based on total NUMBER of accounts carried.

Amount percentages based on total AMOUNT of accounts carried.

EXHIBIT No. 10

PACIFIC NATIONAL COMPANY LOS ANGELES

	YEAR 1927	YEAR 1928
Number of Lots Sold (Including Completed Sales)	14	243
Total Selling Price	$57,255.00	$780,771.25
Commissions on Sales	$18,113.40	$255,597.90
Ratio of Commission to Sales Price	31.63%	32.72%
Cost of Lots Sold	$30,735.99	$414,608.91
Cost of Lots plus Commission	$48,849.39	$670,230.81
Gross Profit to be Realized	$ 8,405.61	$110,548.44
Ratio of Profit to Selling Price	14.68%	14.26%

EXHIBIT No. 11

PART I

DELINQUENT

Form 1041

Treasury Department
Internal Revenue Service
(Auditor's Stamp)

FIDUCIARY RETURN OF INCOME
For Calendar Year 1927

File This Return Not Later Than the 15th Day of the Third Month Following the Close of the Taxable Year

(Print Names and Address Plainly Below)

Name of Estate or Trust CULVER CITY SPEEDWAY TRUST NO. 46

Name and Address of Fiduciary { The Pacific National Bank of Los Angeles, Trustee under its private trust No. 46. Bank of America National Trust and Savings Bank, Head Office, Los Angeles, Successor in Interest.

1. Was a return of income for 1926 filed on behalf of the estate or trust named above? No

* * * * * * * * *

3. Give date of creation of trust or decedent's death July 1, 1927

4. State whether books are kept on cash or accrual basis Cash and Installment Basis.

Item and Instruction No. INCOME

* * * * * * * * *

6. Profit from Sale of Real Estate, Stocks, Bonds, etc. (From Schedule C) $4,821.43

* * * * * * * * *

9. Total Income in Items 1 to 8..... $4,821.43

DEDUCTIONS

* * * * * * * * *

17. Net Income (Item 9 minus Item 16)..... $4,821.43

18. BENEFICIARIES' SHARES OF INCOME AND CREDITS

(See Instruction 18)

1. Name and Address of Each Beneficiary (Designate surviving spouse and nonresident aliens)	2. Percentage of Beneficial Interest	4. Balance of Net Income (Item 17 minus Item 7 (a)
(a) Pacific National Company,	$	$
(b) 315 West Ninth Street, Los Angeles	100	4,821 43

SCHEDULE C—PROFIT FROM SALE OF REAL ESTATE, STOCKS, BONDS, ETC. (See Instruction 6)

1. Kind of Property	8. Net Profit or Loss (Enter as Item 6)
Real Estate Installment Sales—Realized Profit	$4,821.43
Schedule Attached	

* * * * * * * * *

AFFIDAVIT

I swear (or affirm) that this return, including the accompanying schedules and statements, has been examined by me, and, to the best of my knowledge and belief, is a true and complete return, made in good faith for the accounting period stated, pursuant to the Revenue Act of 1932 and the Regulations issued thereunder.

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION, Successor Trustee to Pacific National Bank of Los Angeles

(Signature of fiduciary or officer representing fiduciary)

By A. J. Robillard

Assistant Trust Officer

(Address of fiduciary or officer)

Sworn to and subscribed before me this 3rd day of January, 1935.

[Notarial Seal] Paul F. Chapman

Notary Public in and for the County of Los Angeles, State of California

(Title) (Signature of officer administering oath)

See Instruction 24

(An Amended Return must be plainly marked "Amended" across face of return)

PACIFIC NATIONAL COMPANY LOS ANGELES

CULVER CITY SUBDIVISION SALES
FOR THE YEAR 1927

DATE OF SALE	NAME	LOT NO.	SELLING PRICE	COMMISSION PAID OR ACCRUED	COST OF LOT	TOTAL NET REALIZABLE PROFIT
11/23	Olive L. Brown	7	$10,495.00	$ 3,673.40	$ 5,532.10	$1,289.50
	* * * * * * * * *					
	TOTALS		$57,255.00	$18,113.40	$30,735.99	$8,405.61

1927 PAYMENTS RECEIVED	1927 TAXABLE NET PROFIT	BALANCE OF REALIZABLE NET PROFIT	1928 PAYMENTS RECEIVED	1928 TAXABLE NET PROFIT	BALANCE OF REALIZABLE NET PROFIT
$ 2,624.00	$ 322.38	$ 967.12	$1,026.84	$ 126.11	$ 841.01
* * * * * * * * *					
$15,302.01	$4,821.43	$3,584.18	$4,533.15	$1,010.55	$2,573.63

EXHIBIT No. 11

PART II

DELINQUENT

Form 1041
U. S. Internal Revenue
(Auditor's Stamp)

FIDUCIARY RETURN OF INCOME
For Calendar Year 1928

File This Return Not Later Than the 15th Day of the Third Month Following the Close of the Taxable Year

(Print Names and Address Plainly Below)

Name of Estate or Trust CULVER CITY SPEEDWAY TRUST NO. 46

Name and Address of Fiduciary { The Pacific National Bank of Los Angeles, Trustee under its private trust No. 46. Bank of America National Trust and Savings Bank, Head Office, Los Angeles, Successor in Interest.

1. Was a return of income for 1927 filed on behalf of the estate or trust named above? Delinquent return filed November ...., 1934

2. If so, to what collector's office was it sent (give district or city and State)? Los Angeles

3. Give date of creation of trust or decedent's death July 1, 1927

Item and Instruction No.	INCOME	
* * * * * * * * * *		
2.	Interest on Bank Deposits, Notes, and Corporation Bonds, etc. (except interest upon which a tax was paid at source)	$14,962 77
* * * * * * * * * *		
5.	Profit from sale of Real Estate, Stocks, Bonds, etc. (From Schedule C)	39,226 67
* * * * * * * * * *		
8.	Total Income in Items 1 to 7	$54,189.44
	DEDUCTIONS	
9.	Interest Paid	$16,500 00
10.	Taxes Paid	18,571 42
* * * * * * * * * *		
14.	Other Deductions Authorized by Law. (Explain in Schedule E) Tract Expense	4,044 56
15.	Total Deductions in Items 9 to 14	$39,115 98
16.	Net Income (Item 8 minus Item 15)	$15,073.46

BENEFICIARIES' SHARES OF INCOME AND CREDITS

(See Instruction 17)

1. Name and Address of Each Beneficiary (Designate nonresident aliens)	2. Percentage of Beneficial Interest	4. Balance of Net Income (Item 16 minus Item 6)
(a) Pacific National Company	$	$
(b) 315 West Ninth Street, Los Angeles	100	15,073 46

* * * * * * * * *

SCHEDULE C—PROFIT FROM SALE OF REAL ESTATE, STOCKS, BONDS, ETC. (See Instruction 5)

1. Kind of Property	8. Net Profit (Enter as Item 5)
Real Estate Installment Sales—Realized Profit—1927 Sales	$ 1,010 55
Real Estate Installment Sales—Realized Profit—1928 Sales	38 216 12
TOTAL	$39,226 67

SCHEDULES ATTACHED

* * * * * * * * *

AFFIDAVIT

I swear (or affirm) that this return, including the accompanying schedules and statements (if any), has been examined by me, and, to the best of my knowledge and belief, is a true and complete return made in good faith for the accounting period as stated, pursuant to the Revenue Act of 1928 and the Regulations issued under authority thereof.

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION, Successor Trustee to Pacific National Bank of Los Angeles

(Signature of fiduciary or officer representing fiduciary)

By A. J. ROBILLARD

Assistant Trust Officer

(Address of fiduciary or officer)

Sworn to and subscribed before me this 3rd day of January, 1935

Paul F. Chapman

(Signature of officer administering oath)

NOTARY PUBLIC In and for the County of Los Angeles, State of California

(Title)

(An amended return must be plainly marked "Amended" across face of return)

PACIFIC NATIONAL COMPANY LOS ANGELES

CULVER CITY SUBDIVISION TRUST SALES FOR THE YEAR 1928

DATE OF SALE	NAME	LOT NO.	SELLING PRICE	COMMISSION PAID OR ACCRUED	COST OF LOT
4/12	Wm. I. and Lena M. Smith	3	$ 5,000.00	$ 1,750.00	$ 2,635.84
	* * * * * * * * *				
	TOTALS		$781,984.25	$255,854.45	$414,608.91

TOTAL NET REALIZABLE PROFIT	1928 PAYMENTS RECEIVED	1928 TAXABLE NET PROFIT	BALANCE OF REALIZABLE PROFIT
$ 614.16	$ 1,231.25	$ 151.23	$ 462.93
* * * * * * *			
$111,520.89	$265,961.22	$ 38,216.12	$ 73,304.77

EXHIBIT NO. 12

IT:E:RR
EBP

July 17, 1928.

Mr. Dana Latham,
Southern Building,
Washington, D. C.

In re: Trust S-6165,
Title Insurance and Trust Company,
Los Angeles, California.

Sir:

Receipt is acknowledged of your letter of July 10, 1928, setting forth the following facts in connection with the filing of the 1927 income tax return of the above-named trust and requesting a ruling to the effect that the return for the taxpayer be considered to have been filed as a trust and not as an association, and that the election filed with your letter be considered as meeting the provisions of Section 704(b) of the Revenue Act of 1928, wherefore the tax liability of the taxpayer for the year 1927 is determinable on the basis of the trust and not as an association.

You set forth substantially the following facts:

During March, 1928 and prior to any knowledge that Section 704(b), as now enacted in the Revenue Act of 1928, would become law, two individuals interested in the trust, W. F. Thompson and K. W. Thompson, in their own behalf, without the consent or acquiescence of the trustee, filed a return as an association for the calendar

year 1927, which return purported to cover Trust S-6165. The sole purpose of filing this return was to expedite audit, with a view to obtaining a quicker determination of the tax liability of the trust and a more speedy distribution of the funds then being withheld by the trustee. As is well known, at that time many hundreds of similar trusts were being treated by the Bureau of Internal Revenue as associations, and it appeared that litigation extending over a number of years must inevitably ensue. The filing of the return as an association did not amount to an admission by the Thompsons that said trust was an association, but was merely done in order to quickly close the case.

On March 15, 1928, the Title Insurance and Trust Company, the trustee designated under the declaration

of the trust, filed with the Collector of Internal Revenue for the Sixth District of California at Los Angeles, California, a return on Form 1041 in behalf of said trust. This was the same procedure which had been followed in behalf of said trust from the date of its creation. The trustee has never recognized or consented either expressly or by implication, to the return as an association filed by the Thompson brothers.

Since the enactment of the Revenue Act of 1928 trustee elects, as provided by Section 704(b) of that Act, to have said trust taxed as a trust and not as an association, from the date of its organization through December 31, 1927.

You request that the return filed by the trustee on Form 1041 for the year 1927 be accepted as the original return for the trust, filed as a trust; that the election executed by the trustee under date of July 3, 1928, filed with your letter, be accepted as a proper exercise of the option provided for in Section 704(b) of the Revenue Act of 1928; and that in accordance with such fulfillment of the provisions of Section 704(b), a ruling be made to the effect that the trust is taxable for the year 1927 as a trust and not as an association.

It appears from the evidence that the trust was created, with a single trustee, for the sole purpose of liquidating real property as a single venture. It further appears that the trustee, under date of July 3, 1928, by an option executed in conformity with the requirements of Section 704(b), elects that the trust be taxed as a trust and not as an association. The only question remaining is whether the return alleged to have been filed by the trustee on March 15, 1928 for the year 1927, as a trust, should be deemed as the proper return and so considered in determining the question of whether or not the trust filed its original return for 1927 as a trust and not as an association.

It is the opinion of this office that inasmuch as trustees are the proper persons to file returns for trusts, and are the only persons required by law to do so, and as it further appears from the trust instrument in this case that the trustee was the only agency authorized to bind the trust, the return filed on March 15, 1928 by the trustee of Trust S-6165, Title Insurance and Trust Company, is to be recognized as the return of the taxpayer in preference to any other returns filed by other persons not prop-

erly authorized by the trustee to make returns for the said trust

In view of the above, you are advised that, if as a matter of fact, the trustee of Trust S-6165, Title Insurance and Trust Company,

– 3 –

Mr. Dana Latham.

filed a return on Form 1041 on March 15, 1928 for the year 1927 and did not authorize the filing of any other return for the trust for the year in question, such return is to be recognized as the return of the trust for that year. You are further advised that, assuming that Form 1041 was filed by the trustee for the year 1927 as set forth in the preceding sentence, it appears that all the requirements of Section 704(b) of the Revenue Act of 1928 have been met, and the concern is taxable for the year 1927 and prior years as a trust and not as an association.

Respectfully,

C. B. ALLEN,
Deputy Commissioner,
By L. K. SUNDERLIN
Chief of Section.

JB-4

Thereupon, the Plaintiff rested and moved for judgment and requested special findings of fact and conclusions of law; the Defendant filed the following motion for judgment; requested special findings of fact and conclusions of law, and rested.

IN THE DISTRICT COURT OF THE UNITED STATES IN AND FOR THE SOUTHERN DISTRICT OF CALIFORNIA CENTRAL DIVISION

PACIFIC NATIONAL COMPANY, a corporation, Plaintiff, vs. GALEN H. WELCH, Former Collector of Internal Revenue for the Sixth District of California, Defendant.	No. 5827-M MOTION FOR JUDGMENT.

Comes now the defendant, by and through his attorneys, Peirson M. Hall, United States Attorney for the Southern District of California, M. D. Gallaher, Assistant United States Attorney for said District, and Eugene Harpole, Special Attorney, Bureau of Internal Revenue, and moves the Court for judgment in his behalf on the ground and for the reason that there is no substantial or sufficient evidence before the Court upon which to base a judgment for the plaintiff.

Dated: This 19th day of February, 1935.

Peirson M. Hall – E. H.
PEIRSON M. HALL,
United States Attorney,

M. D. Gallaher – E. H.
M. D. GALLAHER
Assistant United States Attorney,

Eugene Harpole
EUGENE HARPOLE,
Special Attorney,

U. S. Bureau of Internal Revenue,
Counsel for Defendant.

The case was then argued verbally by the respective counsel and the parties were instructed by the Court to file their requested special findings of fact and conclusions of law within ten days, which was done by both parties.

On March 8, 1935, the Court filed a minute order finding for the Defendant. The Court made and filed its own findings of fact and conclusions of law. The findings of fact and conclusions of law proposed by the Plaintiff were not adopted by the Court but were ordered filed. Exception noted and allowed to the Plaintiff.

The special findings of fact and conclusions of law requested by the Plaintiff and denied by the Court, of which denial the Plaintiff took and was allowed an exception, are as follows:

IN THE UNITED STATES DISTRICT COURT
IN AND FOR THE SOUTHERN DISTRICT
OF CALIFORNIA CENTRAL
DIVISION

PACIFIC NATIONAL COMPANY, a corporation, Plaintiff, vs. GALEN H. WELCH, Former Collector of Internal Revenue for the Sixth District of California, Defendant.	At Law No. 5827-M PLAINTIFF'S SPECIAL FINDINGS OF FACT and CONCLUSIONS OF LAW

This cause came on regularly for trial on the 19th day of February, 1935, before the Court, sitting without a Jury, trial by Jury having been waived by written Stipulation of the parties hereto; Plaintiff appearing by Melvin D. Wilson, Esq., its Attorney, and Defendant appearing by Pierson M. Hall, Esq., United States Attorney for the Southern District of California, and Eugene Harpole, Esq., Assistant United States Attorney for said District; and evidence, both oral and documentary having been received, and the Court having fully considered the same, hereby makes the following special findings of fact:

I.

That the jurisdiction of this Court is dependent upon a Federal question in that the cause arises under the laws of the United States pertaining to Internal Revenue, to-wit: The Revenue Act of 1928.

II.

Plaintiff herein is, and during all the times hereinafter mentioned was, a corporation organized under the laws of the State of California, and has its principal office and place of business in the Pacific National Bank Building, 315 West Ninth Street, Los Angeles, California.

III.

That the Defendant, Galen H. Welch, was, from April 6, 1926, to June 30, 1933, the duly commissioned and acting Collector of Internal Revenue for the Sixth Collection District of California, pursuant to the Laws of the United States, and during all the times hereinafter mentioned, resided, and still resides, and has his office in the City of Los Angeles, County of Los Angeles, State of California.

IV.

That this action is brought against the Defendant as a former officer acting under and by virtue of the Revenue Act of 1928, in effect for the year 1928, on account of acts done under color of his office and of the Revenue Laws of the United States, as will hereinafter more fully appear.

V.

That Plaintiff filed with the proper officer designated by Statute, its corporation income tax return for the calendar year 1928, as required by law, within the statutory period, to-wit: On or about the 14th day of March, 1929, and paid a tax to the Defendant of $10,761.28, as follows:

March 14, 1929 –	$ 2,690.30
June 12, 1929 –	2,690.30
September 11, 1929 –	2,690.34
December 12, 1929 –	2,690.34
Total –	$10,761.28

VI.

ORGANIZATION OF PLAINTIFF COMPANY.

Plaintiff was organized in 1925 under the laws of California. Throughout its existence it has had its principal office and place of business in the Pacific National Building, Los Angeles, California. Plaintiff was organized to, and did, hold stocks of various companies, and other securities. Throughout 1928, Plaintiff held more than 95 per cent of the stock of Pacific National Building Corporation, which Corporation filed a separate Federal Corporate Income Tax Return for the year 1928. Plaintiff also held, throughout 1928, over 80 per cent of the stock of Pacific National Bank. Plaintiff had, throughout 1928, numerous stockholders. In 1925, 1926 and 1927, Plaintiff sustained losses which were reflected in its Federal Corporation Income Tax Returns filed for those years.

VII.

THE TRUST.

Around the middle of 1927, Plaintiff purchased, from Pacific National Bank and Hammond Lumber Company, a tract of land near Culver City, California. Plaintiff paid $309,000 cash and gave its Notes for $300,000, as consideration for the purchase of said land. Plaintiff conveyed the title to this land to the Pacific National Bank as Trustee and became the sole beneficiary of Trust No. P. T. 46, Pacific National Bank, Trustee. The Trust Indenture, executed by the Trustee, provided that the Notes executed by Plaintiff, amounting to $300,000, would be secured by a first lien on the real property in the Trust; that the real property might be subdivided, improved and

sold by the Trustee; that the Trustee would, so far as able from moneys coming into it from sale of lots, or from the beneficiary, pay all taxes, sales' commissions, Trustee's fees, $700 per lot on the encumbrance on the property, some amount from the sale of each lot towards the cost of improvements, and other costs and expenses of the Trust. The remainder, if any, was to be paid to the beneficiary. The beneficial interest was divisible. The Trust was commonly known as the Culver City Speedway Trust.

VIII.

In August of 1927 the Trustee, Pacific National Bank, negotiated with Mr. W. H. Elwell to subdivide and sell the property for such prices and terms as would recover to Plaintiff its investment in the Trust. The Trustee represented to Mr. Elwell that the entire subdivision, including the speedway property, was available for sale. Mr. Elwell, after studying the situation, estimated that he could sell the residential lots for $800 or $900, and the business lots at about $75 per front foot; that at such prices the property would find a market and such prices would return to Plaintiff its investment. Mr. Elwell planned to charge total commissions of around 20 per cent; he planned to use conventional, conservative sales methods. Subsequently, the Trustee advised Mr. Elwell that they had mistakenly assumed that the race track property was available for sale, but that it was not so available, but that it was desired to sell the lots at a sufficiently increased price to net the same total investment to Plaintiff. Mr. Elwell was of the opinion that this would force so high a price on the lots that he could not sell them. He wished to withdraw from the engagement but, at the request of the Trustee, kept on trying to sell lots for several weeks.

IX.

On the 24th of October, 1927, the Plaintiff entered into an Agreement with Mr. Frank J. Brick, whereby Mr. Brick was to act as sales agent for Trust No. P. T. 46, Pacific National Bank, Trustee. Mr. Brick had a very large sales force. Under the contract with Mr. Brick, Mr. Brick was to get selling commissions of 35 per cent of the selling price. A new schedule of prices was made up which increased the selling price of residential lots to an average of around $2,400. The business lots were substantially increased and in many instances doubled over the prices originally set by Mr. Elwell. The Agreement with Mr. Brick also provided that if he were able to sell the lots for prices higher than the list price in his contract, he was to get one-half of the excess. Mr. Brick's contract took effect November 1, 1927, and he used a very large sales force; employed the free lunch and lecture system, and sold lots to persons by the use of various other high-pressure methods. His salesmen greatly exaggerated the value and prospects of the property, such exaggerations sometimes running into untruths.

X.

Mr. Elwell was to get an overriding commission of 1 per cent on Mr. Brick's sales. Mr. Elwell's overriding commission was to be paid after Mr. Bricks' commissions were paid. Because of the numerous delinquencies, forfeitures, and cancellations, Mr. Elwell only received $1,600 from those overriding commissions although the sales in 1927 and 1928 alone were $838,026.25, on which his commission should have been $8,380.26.

The balance due the Trustee, on December 31, 1928, from 1928 installment sales contracts, was $489,974.59.

This balance had a fair market value of 66-2/3 per cent, or $326,649.72. If the income of the Trust for 1928 had been computed on the closed basis, but the contracts had been included at their fair market value, the Trust would not have had an income, but a loss, and Plaintiff would have had no taxable income and no tax liability.

The Plaintiff signed the contract with Mr. Brick according to the custom among Trust Companies in connection with subdivision trusts. In such cases the Trustees refused to sign the agency agreement.

XI.

By December 31, 1928, the condition of the contracts relating to the sale of lots in this Trust was as follows:

STATEMENT OF PERCENTAGES ON BASIS OF AMOUNTS AND NUMBER OF ACCOUNTS

	Number		Amount	
	Actual	Percent	Actual	Percent
Paying Accounts	136	60%	$323,762.32	62%
Delinquent Accounts	92	40%	201,674.56	38%
Totals –	228	100%	$525,436.94	100%
Cancelled Accounts	16	6%	$ 35,274.51	6-3/5%
Cash Sales	13	5-3/5%	$ 41,144.25	7-4/5%

Number percentages based on total NUMBER of accounts carried.

Amount percentages based on total AMOUNT of accounts carried.

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XII.

The large commissions necessarily incurred in the selling of the lots in this Trust, and the small possible profit to the Trust after the cost of the land and improvements and selling commissions, are shown by the following statistics:

	Year 1927	Year 1928
Number of Lots Sold (Including Completed Sales) –	14	243
Total Selling Price –	$57,255.00	$780,771.25
Commissions on Sales –	$18,113.40	$255,597.90
Ratio of Commission to Sales Price –	31.63%	32.72%
Cost of Lots Sold –	$30,735.99	$414,608.91
Cost of Lots Plus Commission –	$48,849.39	$670,230.81
Gross Profit to be Realized –	$ 8,405.61	$110,548.44
Ratio of Profit to Selling Price –	14.68%	14.26%

XIII.

The Pacific National Bank, Trustee, kept books for Trust No. P. T. 46, on the basis of cash receipts and disbursements. The Pacific National Bank, as Trustee for Trust No. P. T. 46, did not file Fiduciary, or other, income tax returns for the Trust for 1927 or 1928.

On July 17, 1929, Transamerica Corporation purchased, from Plaintiff, the stock it held in Pacific National Bank. By the terms of this transaction, Plaintiff guaranteed the assets of the Pacific National Bank. Plaintiff received shares of stock of Transamerica Corporation in consideration for the stock in Pacific National Bank given up by Plaintiff. The Pacific National Bank was absorbed by the Bank of Italy and its successor, Bank of America,

and Trust No. P. T. 46 was thereafter designated by the Bank of Italy as Trust No. P. N. 46.

On August 4, 1930, the Title Guarantee and Trust Company became Trustee of Trust No. P. N. 46, formerly Trust No. P. T. 46, and designated the Trust as Trust No. S-1542, Title Guarantee and Trust Company, Trustee.

In 1934 the Bank of America National Trust & Savings Association became the Trustee of Trust No. S-1542, formerly Trust No. P. N. 46, formerly Trust No. P. T. 46.

XIV.

On January 3, 1935, the Bank of America National Trust & Savings Association, successor Trustee of Trust No. P. T. 46, filed Fiduciary returns for the Trust for the years 1927 and 1928. Such returns were filed on the installment basis.

XV.

On the installment basis Trust No. P. T. 46, Pacific National Bank, Trustee, for 1928, either sustained a loss or an income less than the loss sustained by Plaintiff in 1928 from its operations exclusive of Trust No. P. T. 46.

XVI.

BOOKS AND RETURN OF PLAINTIFF.

The books of Plaintiff were kept from its organization and throughout 1928, by F. W. Shelton, Secretary of the Company. Mr. Shelton, in 1928, was 26 years of age. Prior to becoming Secretary of Plaintiff, in 1925, he had been a teller and a bookkeeper in a Bank. In

1925, he became Secretary of Plaintiff upon its organization and thereafter kept its books and filed its income tax returns. The above description of his tax and accounting experience includes all of his business experience. He is a high school graduate.

Trust No. P. T. 46 was organized on July 1, 1927 and its property was subdivided, and a large part of it was sold before August 1, 1928. Beginning in August, 1928, Mr. Shelton, from the reports received by the Trustee, entered all of the transactions of the Trust, from the beginning, on the books of Plaintiff. On each ledger sheet of Plaintiff's books, relating to transactions of the Trust, appeared some designation indicating that it was an account with the Trustee of Trust No. P. T. 46, or of the land in that Trust. Mr. Shelton had no instructions, assistance, or advice from anyone, either within the Company or in the Bank, or otherwise, relative to the method of keeping the books of the Plaintiff.

XVII.

Mr. Shelton prepared the 1928 Federal income tax return of Plaintiff. In preparing this return he had no instructions or assistance or advice from any other officer of the Company, or from anyone connected with the Pacific National Bank, or from any outside tax consultant, or other person. In the 1928 Federal return of Plaintiff, Mr. Shelton included all of the activities of the Trust from its inception on July 1, 1927. He included sales made in 1927, amounting to $57,255, on which he calculated a net profit of $8,405.61. In this return Mr. Shelton failed to take depreciation on depreciable assets belonging to Plaintiff, and also failed to take depletion

deductions on oil producing property belonging to Plaintiff. Mr. Shelton included, in the return of Plaintiff, $137,007.17 as being Plaintiff's income from Trust No. P. T. 46. This income included $8,405.61 from the 1927 operations of the Trust. This income was computed on the basis of treating the contracts for the sale of the lots as having a fair market value equal to the face value of such contracts. Mr. Shelton thought that this procedure was necessary as he thought that if 25 per cent or more of the total selling price of the lot was received in the year of sale, the entire estimated profit on the lot had to be included as taxable income in the year of sale. He did not know that the Revenue Act of 1928 allowed profits on the sale of real estate to be returned on the installment basis if the initial collections amounted to 40 per cent of the selling price. He did not know that the Revenue Act of 1928 increased this percentage from 25 per cent to 40% over the provisions of the 1926 Revenue Act. Mr. Shelton did not know that even when a sale had to be returned on the closed or completed basis, the seller was required to report, as gross income, in the year of sale, the fair market value of the contract only. Mr. Shelton did not know that where the sale had to be returned on the closed or completed basis that the collections could be treated as return of capital until the cost had all been recovered, after which, subsequent collections would be treated as income. Mr. Shelton did not know that the law or regulations permitted more than one way of reporting sales of real estate which were sold under contract, and did not know that the seller could elect the method and would be bound by the method he selected.

The inclusion in the 1928 return of $137,007.17, as being the income of Trust No. P. T. 46, was not based, grounded, or influenced on or by the fact that Plaintiff had net losses for previous years, which were taken as deductions in the 1928 return, as follows:

1925 –	$ 1,990.77
1926 –	$ 9,708.66
1927 –	$24,150.03

XVIII.

Regulations 74, under the Revenue Act of 1928, were not promulgated until February 15, 1929, and were printed and distributed after that date.

XIX.

CLAIMS.

In the late fall of 1930, Messers. Kahan and Seltzer, Certified Public Accountants, were employed to audit the books of Plaintiff. They noticed that the activities of Trust No. P. T. 46 were recorded on the books of Plaintiff and that Plaintiff had calculated the large income from the Trust activities in 1928 on the closed basis and had paid income tax on the same. Mr. Kahan prepared a Claim for Refund for the tax paid by Plaintiff on its 1928 return, and filed the same on February 26, 1931. The basis for the Claim was the exclusion from Plaintiff's income of all income from Trust No. P. T. 46 for 1928.

XX.

In April or May of 1931, the Internal Revenue Agent began the audit of Plaintiff's Claim for Refund of 1928 tax. He contacted Messrs. Kahan and Seltzer who advised him that the income of Trust No. P. T. 46 should

be excluded from the 1928 income of Plaintiff for the reasons set forth in the original Claim and for the further reason that Trust No. P. T. 46 was an association for 1928 and as such should have filed a separate corporate income tax return; that Plaintiff owned all the stock of Pacific National Building Corporation for 1928, but that the two Companies had filed separate returns and therefore all Companies affiliated with Pacific National Company should file separate income tax returns for 1928. About May 15, 1931, Mr. Kahan, on behalf of Plaintiff, handed the Revenue Agent a typewritten memorandum of authorities tending to show that Trust No. P. T. 46 was an association taxable as a corporation.

XXI.

The Revenue Agent completed his report on the audit of the Plaintiff's 1928 Claim for Refund on June 16, 1931, and mailed a copy to the Plaintiff on or about July 15, 1931. His report denied that the Trust was an association taxable as a corporation. Plaintiff filed a written protest to the Revenue Agent's Report on July 27, 1931, and again on September 11, 1931. Plaintiff, through Harry Kahan, Certified Public Accountant, its tax counsel, had a conference in the office of the Internal Revenue Agent in Charge, at Los Angeles, California, on Plaintiff's 1928 Claim for Refund, on August 25, 1931. On September 23, 1931, the Conferee in the office of the Internal Revenue Agent in Charge, in a letter addressed to Plaintiff, ruled that Trust No. P. T. 46 was not an association, and advised that the file would be forwarded to the Commissioner of Internal Revenue at Washington, D. C.

XXII.

After further correspondence between Plaintiff and the Commissioner of Internal Revenue at Washington, D. C., the Commissioner, on February 15, 1932, in a letter addressed to Plaintiff, ruled that Trust No. P. T. 46 was not an association and that Plaintiff's Claim would be denied for $9,669.89, and allowed for $1,091.39 on other points not material to this suit.

XXIII.

On April 1, 1932, Plaintiff's Attorneys had a conference with the Commissioner of Internal Revenue in Washington, D. C., on the original and amended Claim for Refund.

XXIV.

While the audit of the original and amended Claim for Refund was still pending, Plaintiff, on April 4, 1932, filed, on Form 843, its supplement or amendment to its Claim for Refund setting out the theory that Trust No. P. T. 46 was an association and as such should have filed a separate corporate return, and that the income of the Trust should be excluded from Plaintiff's income.

XXV.

On May 17, 1932, the Commissioner of Internal Revenue rejected Plaintiff's original and supplemental or amended Claim for Refund. This suit was instituted on August 19, 1932.

XXVI.

Plaintiff still owns its original and supplemental or amended Claim for the refund of 1928 Federal corporate income tax.

XXVII.

SUBSEQUENT HISTORY OF TRUST AND PLAINTIFF.

Plaintiff has never received any money or property from Trust No. P. T. 46, or Trust No. P. N. 46, or Trust No. S-1542, or from the Culver City Speedway Trust by whatever name known and by whatever Trustee administered.

XXVIII.

On December 23, 1931, Plaintiff assigned to Transamerica Corporation its stock of Transamerica Corporation acquired in exchange for Pacific National Bank stock, and its entire beneficial interest in this Trust under the contract dated July 17, 1929, by which Plaintiff guaranteed the assets of Pacific National Bank. As of December 23, 1931, there was still an encumbrance on the property held in this Trust, which encumbrance amounted to $126,785.

XXIX.

Plaintiff lost its entire investment in the beneficial interest in Trust No. P. T. 46.

XXX.

Plaintiff sustained a loss in each year of its existence. No income will escape tax if the income from Trust No. P. T. 46 is computed on the installment basis for 1928, or if Trust No. P. T. 46 is considered as an association taxable as a corporation for 1928.

XXXI.

THE ASSOCIATION.

Trust No. P. T. 46, Pacific National Bank, Trustee, was engaged in business for profit and was doing business for profit throughout the year 1928.

XXXII.

The beneficiary of the Trust had control of the Trust and the Trustee through ownership of over 80 per cent of the stock of the Trustee Bank, and through practically interlocking officers and directors. The corporate beneficiary had numerous stockholders.

XXXIII.

Trust No. P. T. 46, its beneficiary, Trustee, sales force and lien holder constituted a body of persons acting together without a charter but upon the methods and form used by incorporated bodies for the prosecution of some common enterprise for profit.

CONCLUSIONS OF LAW

As conclusions of law from the foregoing facts, the Court determines that:

I.

Under the Revenue Act of 1928 a Fiduciary is permitted and required to keep books and file income tax returns upon a method chosen by the Fiduciary and that no one else is permitted or authorized to choose the method of accounting to be used by the Trustee in keeping books and filing income tax returns, and no one else, by their actions, can make a binding election as to the method in which the Trustee must file income tax returns for the

Trust; that if anyone other than the Trustee attempts to file returns for the Trust, or to choose a method of filing a return, or attempts to make an election for the Trustee, such actions are negatory and are specifically repudiated when the Trustee files a return on a different basis.

II.

The Trustee of Trust No. P. T. 46 did not elect to file an income tax return on the closed or completed basis, but did elect to file a return for 1928 for the Trust on the installment basis.

III.

There is no provision of law or regulations permitting or requiring the beneficiary of a Trust to elect the manner in which the beneficiary will report the income of the Trust. The beneficiary of the Trust, under the law and regulations, is required to report its distributive share of the income of the Trust, which distributive share is calculated by the Trustee and under the method of accounting adopted by the Trustee in filing income tax returns for the Trust.

IV.

If a beneficiary of a Trust reports income in its return as being its distributive share of the income of a Trust, but such income is computed on a basis inconsistent with the method of accounting adopted by the Trustee in filing a return for the Trust, the beneficiary is not bound by its election in so reporting; there is no provision in the law or regulations binding the beneficiary to such action; that the Commissioner may assert that the beneficiary is estopped from subsequently changing the method of reporting the income of the Trust, but the estoppel to be

effective must be affirmatively pleaded; the Defendant has not pleaded estoppel in this case and has, therefore, waived the defense of estoppel; if Defendant's plea of election is intended as a plea of estoppel, the plea fails because no income will escape taxation if Plaintiff is permitted to change its method of accounting for the income of the Trust for 1928. The true basis for an estoppel from changing from one method to another of reporting income is that by the change some income will escape tax.

V.

The closed or completed basis of computing income for Trust No. P. T. 46 for 1928, especially where the contracts are treated as being worth their face value, did not correctly reflect the income of the Trust. The installment basis of accounting did correctly reflect the income of the Trust.

If there is any theory of election tending to prevent the beneficiary from changing the method of reporting the income of the Trust, the extenuating circumstances are such that Plaintiff will be relieved or excused from the force of the election.

VI.

Plaintiff is permitted to exclude from its return for 1928, the amount reported by it as being the income of Trust No. P. T. 46, and to include in such return the income or loss of Trust No. P. T. 46, computed on the installment basis.

VII.

Trust No. P. T. 46, for the year 1928, sustained, on the installment basis, either a loss or an income less than the loss of Plaintiff, exclusive of any income or loss from Trust No. P. T. 46.

VIII.

Plaintiff, if Trust No. P. T. 46 is a Trust, is entitled to a refund of 1928 income taxes in the amount of $9,669.89.

IX.

That Trust No. P. T. 46, for the year 1928, together with its beneficiary, its Trustee, its sales force, and its lien holder, constituted a body of persons acting together without a charter but upon the methods and forms used by incorporated bodies for the prosecution of some common enterprise for profit, and was actually engaged in doing business in 1928 and constituted an association taxable as a corporation.

X.

That Trust No. P. T. 46 should have filed a Federal corporate income tax return; that such return should have been a single and separate return from the Federal corporate return filed by Plaintiff, as the affiliated group, which included Plaintiff, this association, and Pacific National Building Corporation, filed separate returns for 1928.

XI.

By virtue of the fact that Trust No. P. T. 46 was an association for 1928 and should have filed a separate corporate income tax return for that year, Plaintiff is entitled to a refund of $9,669.89.

XII.

That the Defendant erroneously collected a tax of $9,669.89 from the Plaintiff, and that the Plaintiff is entitled to recover the sum of $9,669.89, plus interest at 6 per cent per annum from March 14, 1929, on $2,690.30; from June 12, 1929, on $2,690.30; from September 11, 1929, on $2,690.34; and from December 12, 1929, on $1,598.95; together with Plaintiff's costs of suit; that judgment be entered accordingly.

.....

United States District Judge.

Approved as to form according to Rule 44.

PIERSON M. HALL
United States Attorney

By.....
Eugene Harpole
Assistant United States Attorney.

IN THE UNITED STATES DISTRICT COURT IN AND FOR THE SOUTHERN DISTRICT OF CALIFORNIA CENTRAL DIVISION

PACIFIC NATIONAL COMPANY, a corporation, Plaintiff, vs. GALEN H. WELCH, Former Collector of Internal Revenue for the Sixth District of California, Defendant.	)))))))	At Law No. 5827-M STIPULATION FOR EXTENSION OF TIME WITHIN WHICH TO FILE BILL OF EXCEPTIONS

IT IS HEREBY STIPULATED, by and between the respective parties hereto, through their respective counsel, that the time for filing the Bill of Exceptions may, with the approval of the Court, be extended thirty (30) days from and after April 15, 1935.

DATED: April 15, 1935.

MELVIN D. WILSON
Melvin D. Wilson
Attorney for Plaintiff.

PEIRSON M. HALL
Peirson M. Hall,
U. S. Attorney

M. D. GALLAHER
M. D. Gallaher,
Asst. U. S. Attorney

EUGENE HARPOLE
Eugene Harpole,
Special Attorney, Bureau of Internal Revenue

Attorneys for Defendant.

ORDER EXTENDING TIME WITHIN WHICH PLAINTIFF MAY FILE BILL OF EXCEPTIONS

In accordance with the foregoing Stipulation, it is hereby ordered that the Plaintiff may have thirty (30) days from and after April 15, 1935, in which to file its proposed Bill of Exceptions.

DATED: April 15, 1935.

Paul J. McCormick
United States District Judge.

STIPULATION RE APPROVAL OF BILL OF EXCEPTIONS

It is hereby stipulated and agreed by and between attorneys for Plaintiff and Defendant that the foregoing Bill of Exceptions has been presented in time and that it may be approved, allowed and settled by the Judge in the above entitled Court as correct in all respects.

DATED: April 29, 1935.

Melvin D. Wilson
Melvin D. Wilson
Attorney for Plaintiff.

Peirson M. Hall – E. H
Peirson M. Hall,
U. S. Attorney

By Hugh Dickson – E. H.
Hugh Dickson,
Asst. U. S. Attorney

By Eugene Harpole
Eugene Harpole,
Special Attorney for the
Bureau of Internal Revenue.

Attorneys for Defendant.

ORDER APPROVING AND SETTLING BILL OF EXCEPTIONS

The foregoing Bill of Exceptions duly proposed and agreed upon by counsel for the respective parties is correct in all respects and is hereby approved, allowed and settled and made a part of the record herein, and said Bill of Exceptions may be used by the parties, Plaintiff or Defendant, upon any appeal taken by either parties, Plaintiff or Defendant.

DATED: May 2nd, 1935.

Paul J. McCormick
United States District Judge.

[Endorsed]: Received copy of the within Bill of Exceptions this 1st day of May, 1935 Peirson M. Hall – E. H. U. S. Attorney, Eugene Harpole, Attorneys for Defendant. Filed May 2 - 1935 R. S. Zimmerman Clerk By B. B. Hansen, Deputy Clerk.

[TITLE OF COURT AND CAUSE.]

PETITION FOR APPEAL

TO the Honorable Judge of the United States District Court, In and for the Southern District of California, Central Division.

The above-named Plaintiff, feeling aggrieved by the decree rendered and entered in the above-entitled cause on the 5th day of April, 1935, does hereby appeal from said decree to the Circuit Court of Appeals for the Ninth Circuit, for the reasons set forth in the assignment of errors filed herewith, and Plaintiff prays that this appeal be allowed and that citation be issued as provided by law, and that a transcript of the record, proceedings and documents upon which said decree was based, duly authenticated, be sent to the United States Circuit Court of Appeals for the Ninth Circuit, under the rules of such Court in such cases made and provided.

And your Petitioner further prays that the proper order relating to the required security to be required of Plaintiff be made.

Melvin D. Wilson
Melvin D. Wilson
Counsel for Plaintiff.

[Endorsed]: Received copy of the within Petition for Appeal this 1st day of May, 1935 Peirson M. Hall, E. H., U. S. Attorney Eugene Harpole, Attorneys for Defendant. Filed May 23, 1935, R. S. Zimmerman, Clerk by L. Wayne Thomas Deputy Clerk

IN THE UNITED STATES DISTRICT COURT IN AND FOR THE SOUTHERN DISTRICT OF CALIFORNIA CENTRAL DIVISION

PACIFIC NATIONAL COMPANY, a corporation, Plaintiff, vs. GALEN H. WELCH, Former Collector of Internal Revenue for the Sixth District of California, Defendant.	At Law No. 5827-M ASSIGNMENT OF ERRORS

Now comes the Plaintiff in the above-entitled case, and files the following assignment of errors upon which Plaintiff will rely upon its prosecution of the appeal in the above-entitled cause from the decree made by this Honorable Court on the 5th day of April, 1935.

1. The Court erred in its decree in that the evidence is not sufficient to support the special findings.

2. The Court erred in refusing the special findings requested by the Plaintiff.

3. The Court erred in allowing the special findings requested by the Defendant.

4. The Court erred in rendering judgment for Defendant on the facts found.

5. The Court erred in failing to find that the Trustee of Trust No. P. T. 46 filed a fiduciary income tax return for 1927 and 1928 on the installment basis, and that

such return was an election by the Trustee of the installment basis for reporting income for 1928.

6. The Court erred, as a matter of law, in finding that there is any election, in the law or regulations, with respect to the installment or closed basis of reporting sales of real estate.

7. The Court erred, as a matter of law, in failing to find that the election, if any, is on the vendor of real property, and that Plaintiff was not the vendor of real property, and hence there was no election made by Plaintiff.

8. The Court erred, as a matter of law, in failing to find that the Trust, No. P. T. 46, was an entity separate and distinct from Plaintiff, and was the owner and vendor of the land whose sales are involved in this cause.

9. The Court erred in finding that Plaintiff obtained and retained financial benefit and income from the sales of real estate made by Frank J. Brick.

10. The Court erred, as a matter of law, in finding that Plaintiff filed a return for 1928 that met the requirements of law and regulations.

11. The Court erred, as a matter of law, in failing to find that Plaintiff erred in keeping, on its books, a record of the transactions of Trust No. P. T. 46.

12. The Court erred, as a matter of law, in failing to find that the Trustee of a trust is the only person authorized by law to keep its records, choose its method of accounting, choose its method of filing income tax reports, and determine its net income.

13. The Court erred as a matter of law, in failing to find that the Plaintiff could not lawfully include in its return any item as representing the income or loss of the Trust until the Trustee had chosen the method of accounting and reporting, and had computed the income on the method chosen.

14. The Court erred as a matter of law in finding that Plaintiff exercised an election in reporting the income of Trust No. P. T. 46 on the deferred payment plan rather than on the installment plan, which election became final and binding on March 15, 1929.

15. The Court erred, as a matter of law, in failing to find that the basis for a binding election is that the taxpayer is estopped from changing its method of computing income on the ground that some income may escape tax by the operation of the statute of limitations.

16. The Court erred as a matter of law in failing to find that there is no estoppel in the case at bar, as no income would escape tax if Plaintiff were permitted to change from the deferred payment to the installment plan.

17. The Court erred, as a matter of law, in failing to find that before an election can be binding, there must be two inconsistent courses of procedure, that one must have a knowledge of the two inconsistent courses, have knowledge that an election must be made, and make a deliberate choice, with the facts and the law in mind, of one of the inconsistent courses.

18. The Court erred, as a matter of law, in failing to find that Plaintiff, in preparing and filing its 1928 return, lacked any knowledge of the right to file on the installment basis, of the right to report the sales contracts at their fair market values instead of their face values, of the duty to elect one of the procedures, or of the fact that if one method was chosen, this constituted a binding election.

19. The Court erred as a matter of law in failing to find that the installment plan of reporting the income of Trust No. P. T. 46 would correctly reflect the net income of the Trust, or of Plaintiff.

20. The Court erred as a matter of law in failing to find that when the successor Trustee of Trust No. P. T. 46 filed a fiduciary return on the installment basis, this action repudiated and rendered negatory any return or calculation of income made by Plaintiff for the Trust.

21. If the Court was correct in its conclusion that Plaintiff made an election to use the closed or completed method of reporting sales of real estate, then the Court erred as a matter of law in failing to find that there were extenuating circumstances present which should relieve Plaintiff from the binding effect of the election.

22. The Court erred in failing to find that any one or more of the following extenuating circumstances were sufficient to relieve Plaintiff from its election, if any, to report real estate sales on the completed or closed basis.

(a) That Plaintiff did not receive any money from the Trust in 1928, or at any time.

(b) That Plaintiff lost around $600,000 cash in the Trust.

(c) That the Trust, on the installment basis, either had a loss in 1928 or an income insufficient to overcome Plaintiff's loss from other operations.

(d) That Plaintiff was not to receive any money from the Trustee until all costs and expenses had been paid, and these items were never paid.

(e) That Plaintiff could not determine whether it would realize a gain or a loss on the Trust until the entire Trust property had been sold and the Trust property was not all sold by the end of 1928.

(f) That the contracts for the sale of lots were treated as having a fair market value equivalent to their face value, whereas, their fair market value was not over one-half of their face value.

(g) That by the end of 1928 forty per cent of the contracts for the sale of lots were delinquent in interest, or taxes, or principal, or two or more of these items.

(h) That many lot buyers defaulted in the purchase contracts.

(i) That the lots were sold for two or three times their real value by the use of high pressure salesmanship, free lunches and lectures, and very high commissions.

(j) That the closed or completed basis of reporting the income from the sales of real estate did not correctly reflect the net income of the Trust or of Plaintiff.

23. The Court erred, as a matter of law, in failing to find that Trust No. P. T. 46 was, in 1928, an association taxable as a corporation, and should have filed a separate corporation income tax return whose income should be excluded from Plaintiff's return.

24. The Court erred, as a matter of law, in finding that Trust No. P. T. 46, was a fixed Trust in the nature of a mortgage, and a security device, and not an association taxable as a corporation.

25. The Court erred, as a matter of law, in rendering judgment for the Defendant.

WHEREFORE, The Appellant prays that said decree be reversed and that said United States District Court for the Southern District of California, Central Division, be ordered to enter a decree reversing the decision in said cause.

Melvin D. Wilson

Melvin D. Wilson

Attorney for Plaintiff and Appellant.

[Endorsed]: Received copy of the within Assignment of Errors this 1st day of May, 1935 Peirson M. Hall— E. H. U.-S. Attorney Eugene Harpole Attorneys for Defendant. Filed May 23, 1935 R. S. Zimmerman Clerk. By L. Wayne Thomas, Deputy Clerk.

[TITLE OF COURT AND CAUSE.]

ORDER ALLOWING APPEAL

Upon reading the Petition for Appeal of the Plaintiff and Appellant, IT IS HEREBY ORDERED that an appeal to the Circuit Court of Appeals for the Ninth Circuit, from the decree heretofore filed and entered herein, be and the same is hereby allowed, and that a certified transcript of the record, testimony, exhibits, stipulations and all proceedings be forthwith transmitted to the said Circuit Court of Appeals for the Ninth Circuit.

It is further ordered that the bond on appeal to be filed by Plaintiff be fixed at the sum of $250.00 and the same act as a bond for cost on appeal.

DATED: May 23rd, 1935.

Paul J. McCormick
Judge

[Endorsed]: Received copy of the within Order Allowing Appeal this 1st day of May, 1935. Peirson M. Hall—E. H. U. S. Attorney Eugene Harpole, Attorneys for Defendant. Filed May 23, 1935 R. S. Zimmerman, Clerk. by Edmund L. Smith Deputy Clerk.

[TITLE OF COURT AND CAUSE.]

BOND TO COVER COSTS ON APPEAL

KNOW ALL MEN BY THESE PRESENTS: That the PACIFIC NATIONAL COMPANY, the Plaintiff herein, as principal, is held and firmly bound unto GALEN H. WELCH, Former Collector of Internal Revenue for the Sixth District of California, his executors, administrators and assigns, in the sum of Two Hundred and Fifty Dollars ($250.00), to which payment well and truly to be made, PACIFIC NATIONAL COMPANY binds itself, its successors and assigns, jointly and severally, by these presents.

Signed, sealed and dated this 21 day of May, 1935.

WHEREAS, on the 5th day of April, 1935, the above named Court rendered a judgment against the PACIFIC NATIONAL COMPANY and the PACIFIC NATIONAL COMPANY having obtained from said District Court an order allowing it to take an appeal from said Judgment to the United States Circuit Court of Appeals for the Ninth Circuit to reverse the said decision, and having issued a citation directed to the said GALEN H. WELCH, citing and admonishing him to be and appear in the United States Circuit Court of Appeals for the Ninth Circuit, at the City of San Francisco, State of California.

NOW, THEREFORE, the condition of this obligation is such that if the said PACIFIC NATIONAL COMPANY shall prosecute its appeal to effect, and answer all costs and damages occasioned thereby, if it fails to make its plea good, then the above obligation shall be void, otherwise to remain in full force and effect.

PACIFIC NATIONAL COMPANY

BY HARRY KAHAN

(SEAL) Vice-President

By E. C. MAEDER

Secretary

STATE OF CALIFORNIA)
) ss.
County of Los Angeles)

On this 21st day of May, 1935, before me, Mary McWaters, a Notary Public in and for the said County and State, personally appeared HARRY KAHAN and E. C. MAEDER, known to me to be the Vice President and Secretary respectively of PACIFIC NATIONAL COMPANY, the corporation that executed the within instrument, known to me to be the persons who executed the within instrument, on behalf of the PACIFIC NATIONAL COMPANY, and acknowledged to me that they executed the same.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my official seal the day and year in this certificate first above written.

[Seal] MARY McWATERS

Notary Public in and for the County of Los Angeles, State of Califonia.

My Commission Expires Dec. 1, 1938

Taken and approved by me this 23rd day of May, 1935.

Paul J. McCormick

Judge.

[Endorsed]: Filed May 23, 1935 R. S. Zimmerman, Clerk. by Edmund L. Smith Deputy Clerk

[TITLE OF COURT AND CAUSE.]

AMENDED PRAECIPE FOR TRANSCRIPT OF RECORD

To the Clerk of the United States District Court, in and for the Southern District of California, Central Division:

Please issue a certified transcript of record in the above-entitled case on appeal to the Circuit Court of Appeals for the Ninth Circuit, consisting of the following:

1. Amended Bill of Complaint.
2. Answer to Amended Bill of Complaint.
3. Stipulation Waiving Trial by Jury.
4. Special Findings as allowed by Court.
5. Minute Order.
6. The Judgment.
7. Engrossed Bill of Exceptions.
8. Petition for Appeal.
9. Assignment of Errors.
10. Order Allowing Appeal, and Order fixing cost bond.
11. Cost Bond.
12. Citation on Appeal.
13. Stipulation to Minimize Printed Record on Appeal, approved July 30, 1935.
14. Amended Praecipe.

Melvin D. Wilson
Melvin D. Wilson
Counsel for Plaintiff.

[Endorsed]: Received copy of the within Amended Praecipe this 13th day of November, 1936 Eugene Harpole, attorney for defendant. Filed Nov 16 1936 R. S. Zimmerman, Clerk By R. F. Swinney Deputy Clerk.

[Title of Court and Cause.]

CLERK'S CERTIFICATE.

I, R. S. Zimmerman, Clerk of the United States District Court for the Southern District of California, do hereby certify the foregoing volume containing 192 pages, numbered from 1 to 192 inclusive, to be the Transcript of Record on Appeal in the above entitled cause, as printed by the appellant, and presented to me for comparison and certification, and that the same has been compared and corrected by me and contains a full, true and correct copy of the citation; amended complaint; answer; stipulation waiving jury; findings of fact and conclusions of law; order of March 8, 1935; judgment; stipulation to minimize printed record on appeal; bill of exceptions; petition for appeal; assignment of errors; order allowing appeal; bond on appeal, and amended praecipe.

I do further certify that the amount paid for printing the foregoing record on appeal is $270.35 and that said amount has been paid the printer by the appellant herein and a receipted bill is herewith enclosed, also that the fees of the Clerk for comparing, correcting and certifying the foregoing Record on Appeal amount to $29.65 and that said amount has been paid me by the appellant herein.

In Testimony Whereof, I have hereunto set my hand and affixed the Seal of the District Court of the United States of America, in and for the Southern District of California, Central Division, this 25th day of November, in the year of Our Lord One Thousand Nine Hundred and Thirty-six and of our Independence the One Hundred and Sixty-first.

[Seal] R. S. ZIMMERMAN,

Clerk of the District Court of the United States of America, in and for the Southern District of California.

By EDMUND L. SMITH,
Deputy.

[Endorsed]: Printed Transcript of Record. Filed Nov. 27, 1936. Paul P. O'Brien, Clerk.

No. 8394

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

PACIFIC NATIONAL COMPANY,

Appellant,

vs.

GALEN H. WELCH, etc.,

Appellee.

Upon Appeal from the District Court of the United States for the Southern District of California, Central Division.

PROCEEDINGS HAD IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

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United States Circuit Court of Appeals for the Ninth Circuit.

Excerpt from Proceedings of Thursday, April 15, 1937.

Before: Wilbur, Garrecht and Haney, Circuit Judges.

[Title of Cause.]

ORDER OF SUBMISSION.

Ordered appeal in above cause argued by Mr. Melvin D. Wilson, counsel for appellant, and by Mr. Lester L. Gibson, Special Assistant to the Attorney General, counsel for appellee, and submitted to the court for consideration and decision.

United States Circuit Court of Appeals for the Ninth Circuit.

Excerpt from Proceedings of Monday, August 2, 1937.

Before: Garrecht and Denman, Circuit Judges.

[Title of Cause.]

ORDER DIRECTING FILING OF OPINION AND FILING AND RECORDING OF JUDGMENT.

By direction of the court, ordered that the typewritten opinion this day rendered by this Court in above cause be forthwith filed by the clerk, and that a judgment be filed and recorded in the minutes of this court in accordance with the opinion rendered.

[Title of Court and Cause.]

OPINION.

Upon Appeal from the District Court of the United States for the Southern District of California, Central Division.

Before: Wilbur, Garrecht and Haney, Circuit Judges.

Garrecht, Circuit Judge:

This is an appeal from a judgment of the District Court in favor of defendant in an action brought by appellant herein for refund of income taxes for the calendar year 1928. Trial was had to the court upon stipulation waiving jury; no opinion was handed down, but the court made special findings of fact and conclusions of law and judgment was entered accordingly.

The assignments of error are numerous; in our judgment but two questions were raised on appeal: (1) Whether a taxpayer, having filed its income tax return reporting sales contracts for parcels of real estate sold as completed transactions and treating the sales price as having been received, may change its method and later amend the return and report such sales on the installment basis and demand a refund of taxes paid, or is it bound by its choice made in its original return; and (2) if it be held that the taxpayer is bound by its original return, whether the Trust which held the property and to which appellant was the sole beneficiary, was taxable as an association and, therefore, the return

filed by the appellant for the year 1928 was not a proper one in that it should not have included the income of the trust.

The second point, since the argument in this case, has been decided adversely to appellant's contention by the Supreme Court in A. A. Lewis & Company, etc., et al., v. Commissioner of Internal Revenue, 300 U. S. ....., 81 L. Ed. 748.

Some time prior to 1928 the appellant purchased a tract of land in Culver City, County of Los Angeles, California, paying part of the purchase price in cash and giving its promissory notes for the balance. This property was conveyed to the Pacific National Bank in trust as Trustee for Trust No. P. T. 46, and under the Trust Indenture the plaintiff became the sole beneficiary of said trust. The tract was subdivided, streets laid out, etc. Contracts were entered into with selling agents, prices fixed and sales proceeded with. Most of the lots were sold on contract, 25% down and the balance over a period of time.

The appellant was a holding and investment company, originally incorporated with a capital stock of $2,000,000, which was increased in 1928 to $4,000,000. In 1928 it owned over 80 per cent of the stock of Pacific National Bank, as well as over 95 per cent of the stock of Pacific National Building Corporation. This latter corporation and appellant filed separate corporation income tax returns for 1928. The officers of the appellant were officers of the Pacific National Bank.

The trust indenture, Trust No. P. T. 46, was a

security transaction or device, containing recitals that four promissory notes had been made by appellant in favor of one H. W. McLeod for the total sum of $300,000, each note bearing the words, "This note is secured by a certain declaration of trust issued by The Pacific National Bank of Los Angles, * * * dated July 1st, 1927, and known as Trust P. T. 46 and is subject to the terms and conditions thereof." It was further provided in the trust indenture that "The entire sales price of every lot or parcel of said Trust Property, together with all interest on each contract of sale shall be paid to the Trustee [Pacific National Bank]." All contracts of sale, or deeds covering any part of the trust property were to be executed by the trustee.

In the 1928 Federal Income Tax Return the appellant reported an income of $89,677.34, and this income was made up as follows:

Income from Trust No. P. T. 46		$137,007.17
Less:		
Loss of Taxpayer from its 1928 operations exclusive of the trust income	$11,480.37	
Statutory net losses as follows		
1925	1,990.77	
1926	9,708.66	
1927	24,150.03	47,329.83
Net income as reported		$89,677.34

The tax was paid in quarterly installments.

The $137,007.17 representing the income of Trust P.T. 46, Pacific National Bank, Trustee, resulted from the sale of subdivision lots, and in the determination thereof said sales were treated as deferred payment sales not on the installment plan and the obligations of the purchaser were treated as having a fair market value equivalent to their face value.

On February 26, 1931, the appellant filed a claim for refund of the tax paid of $10,761.28 upon the ground that "Profit from sales of real estate in a subdivision trust were erroneously reported as based on closed sales, although the sales were made on the installment basis and proceeds of sales and collections were allocated by the trustee." An amended claim was filed on April 4, 1932, for refund of said tax, upon the ground that "Claimant now wishes to amend the claim by showing that the subdivision trust is a separate entity, an association taxable as a corporation, that it did not file a consolidated return with claimant in 1928, and that its 1928 income can not be included in claimant's income or return. Accordingly, the income of the subdivision must be excluded from claimant's 1928 income, and the tax paid thereon by claimant, refunded. This situation prevents the doctrine of estoppel from applying to this case." The trustee did not file a fiduciary or other income tax return for the years 1927 or 1928.

On or about May 17, 1932, the Commissioner of Internal Revenue rejected that portion of appellant's claim for refund which pertained to the

grounds set forth in this suit. The Commissioner allowed appellant's claim for refund in the amount of $1,091.39, together with interest thereon, based on other grounds not material here. Thereafter the appellant filed the instant suit.

At the trial, F. W. Shelton, who was secretary of the appellant corporation in 1928, testified that in computing the income of the trust for 1928 he treated the sales contracts as being the equivalent of cash. He said he did not know that the 1928 Revenue Act permitted sales to be reported on the installment basis when 25% of the selling price was received in the year of sale; that he understood that the sale had to be treated as a cash or completed sale; that he did not know that sales were permitted to be reported at their fair market value; that he did not know that where the down payment exceeded 40% of the selling price the law permitted the collections to be treated as return of capital until the cost had all been collected, and to then treat the subsequent collections as all income; that he prepared the 1926 and 1927 income tax returns; that he knew that the returns should be prepared on the basis of the method used in keeping books of the reporting company; that he had no consultant advise in the preparation of that return. He further testified that there was a gross profit in the Trust of $306,181.69 for the year 1928, with commissions paid of $182,711.49, and expense on the "Speedway" property of $4,044.56, and that in calculating the income of the trust for 1928 he included the sales that were made in 1927. The trustee kept books of the activities of Trust No. P. T. 46

and furnished the witness with the figures for his ledger. He made the 1928 return entirely from the books of the appellant.

It was shown by this witness' testimony that there had been an assignment of many assets of the appellant to the Transamerica Corporation, but that this claim for refund was expressly excluded from the assignment; that the Guaranty Trust Company later became trustee for the trust here involved.

William H. Elwell, a witness for appellant, testified that he was engaged in the real estate business and had been contacted by an official of the Pacific National Bank to make an estimate of what Culver City Park [Trust No. P.T. 46] could be sold for; that he prepared a map and set prices on the individual lots, so as to exceed the amount of money the bank desired to receive from the sale of the tract; that he had sign boards painted and partly organized a sales force. He was then informed that certain property included in the map was not for sale and that it was desired to obtain the same amount of money from the smaller area. He attempted to sell the lots at the higher figure, but did not care about going on with the contract. A Mr. Frank Brick then took over the sales contract. The witness said that Brick was reported to have used "high pressure closers"; that Brick gave free lunches and had lectures delivered to prospective lot buyers; that, in his opinion, the lecturers were not always truthful; that the lots were sold for prices two or three times higher than the prices he thought they would sell for. He further testified that he did not think the contracts with the buyers were worth their

face value; that he thought the fair market value was one-third to one-half of the selling prices, reduced by the cash down payments.

Mr. Harry Kahan, a certified public accountant, had audited the books of appellant in 1930 and prepared the claim for refund filed February 26, 1931. He testified that the books of appellant were kept strictly on a cash basis; that he prepared from the records of the trustee, a summary of the condition of the contracts for sale of lots of the trust as of December, 1928. This summary was offered and received in evidence as Exhibit No. 9, over objection and exception of defendant-appellee. Another summary prepared by the witness was offered and received in evidence as Exhibit No. 10, also over objection and exception. Exhibit No. 9 indicated that 60 per cent in number, 62 per cent in amount, of the sale accounts were paying accounts; and that 40 per cent, and 38 per cent, of these accounts were delinquent, respectively. It also indicated that 6 3/5 per cent of the accounts (in amount) had been cancelled and 7 4/5 per cent had been paid in cash. Exhibit No. 10 demonstrated that the commission on sales in 1927 was 31.38 per cent and in 1928, 32.72 per cent, of the selling price, and that the ratio of profit to selling price in these years was 14.68 per cent and 14.26 per cent, respectively.

Copies of fiduciary income tax returns for Trust No. P.T. 46 for the years 1927 and 1928, filed on January 3, 1935, were offered in evidence and objected to by counsel for the defendant. The objection was overruled, exception noted and the docu-

ments marked Exhibit No. 11. It appeared, from this exhibit, that there was a net income in the trust for the year 1927 of $4,821.43, and for the year 1928 of $14,073.46.

During the progress of the trial a verbal stipulation was entered into, as follows: "May it please the Court, the defense is agreeable to a stipulation to the effect that should the court decide either that the plaintiff is entitled to change its method of computing income from the completed sale basis to the installment or deferred payment sale basis, or it should be decided that the trust should have reported the income on the basis of an association taxable as a corporation, and should have filed a separate return as a corporation instead of as a trust, that there would be some amount of refund due. They have reserved the right to endeavor to compute that without taking time now. * * * * And further, that if a change of basis was granted, that no income would escape taxation in subsequent years by reason of the Statute of limitations; I do not wish the stipulation to be taken as abandoning our contentions as to the right to change the basis."

In support of its first proposition the appellant argues that its "action in including in its return the income of the trust computed on the completed sale basis constitutes a mistake and not an election".

The taxpayer reported the sales as deferred payment sales, just as they were reflected upon its books. It indicated by its original Income Tax Return for the year 1928 that it chose to report the sales as completed transactions, rather than as installment con-

tracts. By filing its return on that basis it made a choice or election and it may not, at a latter date, when it appears to its advantage to do so, change the method of making its report. Rose, etc., v. Grant (CCA 5), 39 F. (2d) 340, 341; Safety Electric Prod. Co., Inc. v. Helvering, etc. (CCA 9), 70 F. (2d) 439, 441; Alameda Inv. Co. v. McLaughlin (CCA 9), 33 F. (2d) 120; U.S. v. Pettigrew (CCA 9), 81 F. (2d) 666. "The courts have uniformly held that the right of choice or election to file one or another sort of return is exercised by filing the return." Radiant Glass Co. v. Burnet, etc. (Ct. Ap. D.C.), 54 F. (2d) 718, 719. "The present case is not different in principle from those in which a taxpayer, having the right to file either one or two different sorts of returns, makes his choice and files his returns accordingly. It is settled that he cannot afterwards change. Radiant Glass Co. v. Burnet, * * * [supra]. *This is so even where the taxpayer, under a mistake of law, was unaware that he had the right to choose.* Buttolph v. Commissioner, 29 F. (2d) 695 (CCA 7)." Moran v. Commissioner of Internal Revenue (CCA 1), 67 F.(2d) 601. (Italics our own.)

The proposition that "the trust is an association whose income should not have been included in appellant's return but should be reported in a separate return", as indicated above, has been disposed of by the ruling of the Supreme Court in A. A. Lewis & Company, etc., et al., v. Commissioner of Internal Revenue, supra, and requires no further discussion.

The findings of the trial court are supported by substantial evidence and are sufficient to sustain the judgment.

The judgment of the District Court is affirmed.

[Endorsed]: Opinion. Filed Aug. 2, 1937. Paul P. O'Brien, Clerk.

United States Circuit Court of Appeals for the Ninth Circuit

No. 8394

PACIFIC NATIONAL COMPANY,

Appellant,

vs.

GALEN H. WELCH, etc.,

Appellee.

JUDGMENT.

Upon appeal from the District Court of the United States for the Southern District of California, Central Division.

This Cause came on to be heard on the Transcript of the Record from the District Court of the United States for the Southern District of California, Central Division and was duly submitted.

On consideration whereof, it is now here ordered and adjudged by this Court, that the judgment of the said District Court in this Cause be, and hereby is affirmed.

[Endorsed]: Filed and entered Aug. 2, 1937. Paul P. O'Brien, Clerk.

[Title of Court and Cause.]

CERTIFICATE OF CLERK, U. S. CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT, TO RECORD CERTIFIED UNDER RULE 38 OF THE REVISED RULES OF THE SUPREME COURT OF THE UNITD STATES.

I, PAUL P. O'BRIEN, as Clerk of the United States Circuit Court of Appeals for the Ninth Circuit, do hereby certify the foregoing two hundred seven (207) pages, numbered from and including 1 to and including 207, to be a full, true and correct copy of the entire record of the above-entitled case in the said Circuit Court of Appeals, made pursuant to request of counsel for the appellant, and certified under Rule 38 of the Revised Rules of the Supreme Court of the United States, as the originals thereof remain on file and appear of record in my office.

ATTEST my hand and the seal of the said the United States Circuit Court of Appeals for the Ninth Circuit, at the City of San Francisco, in the State of California, this 21st day of September, A. D. 1937.

[Seal] PAUL P. O'BRIEN,
Clerk.

SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed December 6, 1937

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Ninth Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

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FILE COPY

Office - Supreme Court, U.
FILED
OCT 25 1937
CHARLES ELMORE CROPLEY
CLERK

IN THE

SUPREME COURT

OF THE

UNITED STATES.

OCTOBER TERM, 1937.

No. 528

PACIFIC NATIONAL COMPANY,

Petitioner,

v.

GALEN H. WELCH, former Collector of Internal Revenue for the Sixth District of California,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT, AND BRIEF IN SUPPORT THEREOF.

MELVIN D. WILSON,
819 Title Insurance Bldg., Los Angeles,
Counsel for Petitioner.

Parker & Baird Company, Law Printers, Los Angeles.

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IN THE

SUPREME COURT

OF THE

UNITED STATES.

OCTOBER TERM, 1937.

No. .....

PACIFIC NATIONAL COMPANY,

Petitioner,

v.

GALEN H. WELCH, former Collector of Internal Revenue for the Sixth District of California,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

The petitioner prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Ninth Circuit entered in the above-entitled cause on August 2, 1937, affirming the judgment of the United States District Court in and for the Southern District of California, Central Division.

Opinions Below.

The United States District Court did not render a written opinion. A minute order was made, finding for the defendant [R. p. 31]. The opinion of the Circuit Court of Appeals [R. pp. 198 to 207, inclusive] is not yet reported in the Federal Reporter system.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered on August 2, 1937 [R. p. 207]. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by Act of February 13, 1925.

Question Presented.

When a taxpayer, through ignorance of a right to use any other basis, files its 1928 return on a basis which does not clearly reflect its net income, is it bound by the method so used?

Statutes and Regulations Involved.

The statutes and regulations involved will be found in the Appendix hereto, pp. 25 to 27.

Statement.

This case involves a suit for the recovery of corporate Federal income tax for the year 1928 in the amount of $9,669.89, paid by the petitioner to the respondent on the basis of a return in which installment sales of real estate were reported as completed or cash sales and results from the refusal of the Commissioner of Internal Revenue to permit a change to the installment basis.

Around July 1, 1927, petitioner purchased the parcel of land here involved, located on the edge of Culver City, California, on the outskirts of Los Angeles, for $309,000.00 cash and $300,000.00 in notes secured by the land [R. pp. 68-9; p. 44]. Petitioner conveyed title to this property to Pacific National Bank, as trustee, and became the sole beneficiary of the trust, which was numbered P. T. 46 [R. p. 68].

The trustee tried to sell the property in lots through conservative methods and for reasonable prices, but was unable to make many sales [R. pp. 2, 6, 115, 161].

Petitioner then employed Frank J. Brick as sales agent, who doubled and tripled the asking prices of the lots over the previous asking prices, and was to receive a commission of thirty-five per cent., plus one-half of the excess of the selling price over specific asking prices [R. pp. 54-67], in comparison with commissions of fifteen to twenty per cent. previously offered [R. pp. 2, 141].

Mr. Brick had a large sales organization and used the "free lunch and lecture" system, extravagant statements, and high-pressure closers [R. pp. 110, 117]. He sold many lots, beginning late in 1927, and throughout 1928 [R. p. 144], and for about three times their value [R. pp. 117-118].

Out of $265,961.22 received from sales in 1928, the amount of $255,854.45 was payable as commissions. The cost of the land and improvements sold in 1928 was $414,608.91. Trustee's fees of more than $13,298.00 were payable [R. pp. 153, 91].

As of December 31, 1928, six per cent. of the sales contracts had been cancelled, forty per cent. were delin-

quent in principal, taxes or interest, or two or more of these items [R. p. 143]. Subsequently, over eighty per cent. of the 1927 and 1928 buyers cancelled their contracts and failed to make their payments [R. pp. 117-144].

Petitioner was not, by the terms of the trust indenture, to receive anything from the trust until all commissions, trutee's fees, note indebtedness and interest, improvement and other costs, had been paid [R. p. 79]. These costs were not paid as of December 23, 1931, when petitioner transferred the beneficial interest in the trust to Transamerica Corporation, in part payment of a guarantee obligation [R. p. 124]. Consequently, petitioner never received anything from the trust, and hence did not ever recover any of its cash investment of $309,000.00, and did not receive anything in the way of income. In fact petitioner was required to put $50,000 more cash in the trust in 1928 [R. p. 112].

Most of the lots were sold for a down payment of twenty-five per cent. and the balance over a period of years [R. pp. 108, 55]. The average collection in the year of sale was, for 1928 sales, thirty-two per cent. [R. p. 153].

The Revenue Act of 1926 (Sec. 44) provides that if the collections during the year of sale exceeded twenty-five per cent. of the selling price, the sale could not be treated as an installment sale. The 1928 Act (Sec. 44), however, provided that sales could be reported on the installment basis, provided the collections in the year of sale did not exceed forty per cent. of the selling price.

Petitioner's books, however, were kept and its returns prepared by Mr. Shelton, an inexperienced young man,

who received no advice or assistance from anyone [R. pp. 107, 110, 111, 113, 114, 123].

In preparing the 1928 return, Mr. Shelton reported therein as 1928 transactions the 1927 sales, as well as the 1928 sales [R. p. 108], and made other errors [R. pp. 42, 48].

Mr. Shelton did not know about the more liberal provisions of the 1928 Act, and did not know that petitioner was permitted to report on the installment basis, or on the deferred payment plan [R. p. 108]. He understood that the sales were required to be treated, on the books and returns, as cash or completed sales. He got this impression from looking at some book of Regulations [R. p. 108].

The method of accounting and bookkeeping adopted by Mr. Shelton reflected a net income from the trust for 1928 of $137,001.17. This exceeded by $89,677.34 the losses of $47,329.84 sustained by petitioner from its other operations, and a tax of $10,761.28 was paid [R. pp. 41, 2].

After the filing of the return the Commissioner refunded $1,091.39, on account of depreciation and depletion deductions not claimed by Mr. Shelton in the return [R. pp. 42, 48]. The Commissioner refused to refund the remainder of the tax on the ground that petitioner had made a binding election and could not change from the completed to the installment basis [R. p. 16].

It is stipulated that if the income of the trust is computed on the installment basis, there would be a refund due [R. p. 118]. The delinquent return filed by the trustee shows that the entire tax paid would be refund-

able, if the trust income is computed on the installment basis, as the trust income of $15,073.46 would be much less than petitioner's loss from other operations of $47,329.83 [R. pp. 151, 52].

It is further stipulated that no income will escape taxation, by reason of the running of the statute of limitations, if petitioner is permitted to change to the installment basis [R. p. 118].

Specifications of Error to Be Urged.

The court below erred:

In holding that the use of a method of reporting which did not correctly reflect net income, through ignorance of the statutory right to employ another method, constituted a binding election, estopping petitioner from using a statutory method which does correctly reflect net income.

Reasons for Granting the Writ.

1. The decision of the court below is in conflict with *Morrow, Becker & Ewing, Inc., v. Commissioner,* 57 Fed. (2d) 1, 10 A. F. T. R. 1491, decided by the Circuit Court of Appeals for the Fifth Circuit. In that case a real estate company bought a tract of land in Florida and sold all the lots in 1925, mostly on the installment basis. By the end of the year one-sixth of the contracts were in default, as the value of the land was declining. The sales were reported in the return as completed sales, and the Commissioner refused to accept an amended return on the installment basis. The 1926 Act. was passed shortly before the 1925 return was filed, authorizing the use of the installment basis, and retroactively ratifying

the Commissioner's regulations permitting such basis in the absence of statutory provisions therefor in the earlier acts. The court permitted the amended return, as the method originally used did not clearly reflect net income and the taxpayer had scant notice of the provisions of the recently enacted 1926 Act.

In the case at bar, forty per cent. of the contracts were delinquent at the end of the taxable year. Furthermore, the regulations under the 1928 Act were not promulgated until February 15, 1929, and were not available to petitioner when the 1928 return was filed. The 1928 Act changed the method of reporting available to petitioner, but petitioner had no knowledge of it, and had but scant opportunity of examining the regulations under the act.

2. The decision of the court below is in conflict with *Kaplan v. U. S.*, 18 F. Supp. 965, decided by the United States Court of Claims. In that case the taxpayer made a casual sale of personal property, receiving less than forty per cent. of the selling price in the year of sale—1929. This was an installment sale but was reported as a completed sale. The Commissioner rejected a claim for refund filed on the installment basis, claiming that the taxpayer had made a binding election. In 1932, the unpaid purchase price was reduced $75,000.00, which reduced the profit the taxpayer could realize on the transaction and resulted in the original return reflecting an erroneous income. The Court of Claims reversed the Commissioner on two grounds, first, that neither the law or regulations contained a provision for an election with respect to casual sales of personal property, and, second, that there can be no binding election in using a method which does not clearly reflect net income.

In the instant case, neither the statute nor the regulations permitting vendors of real estate to report on the installment basis contain an election. In this case also, the method employed in the original return does not clearly reflect net income.

3. The decision of the court below is in conflict with *Standard Oil Company v. Hawkins,* 74 Fed. 395, decided by the Seventh Circuit. In that case the appellant deposited money in a national bank on the day the bank ceased business and when its officers knew it was hopelessly insolvent. Appellant, ignorant of its right to reclaim the deposit on the ground that it had been fraudulently received, filed a claim as an unsecured creditor. The claim was allowed and a dividend tendered thereon. Appellant then learned of its other right and brought an action to reclaim. The court held that appellant had not made a binding election, as there must be a knowledge of the inconsistent rights before an election can be made.

In the instant case, petitioner was ignorant of a right, granted it in the recently enacted Revenue Act of 1928, to file on the installment basis when the collections in the year of sale exceeded twenty-five per cent., but did not exceed forty per cent. of the selling price. Under such circumstances, petitioner could not have made a conscious or binding election.

4. The court has decided an important question of Federal law which has not been, but should be, settled by this Court.

The question of whether a taxpayer who uses a method which does not correctly or clearly reflect net income, can be estopped by the theory of election of remedies from

using a more favorable method provided by the law, when the law does not contain such an election and the regulations do not clearly contain one, is an important question which has not been, but should be, decided by this Court.

Following is a partial list of cases involving this or a closely analogous point, and which indicate that the decision of the court below is in conflict with the weight of authority:

Key Largo Shores Properties, Inc., 21 B. T. A. 1008;

Tide Water Oil Co., 29 B. T. A. 1208;

United Profit Sharing Corp. v. U. S., 66 Ct. Cl. 171;

Pichmond Hosiery Mills v. Rose, 73 Fed. (2d) 315;

Continental Bank & Trust Co. of N. J. v. U. S., 19 Fed. Supp. 15;

Lucas v. Sterling Oil & Gas Co., 62 Fed. (2d) 951;

Patent Royalties Corp. v. Commissioner, 65 Fed. (2d) 580;

Queen City Woodworks & Lumber Co. v. Crooks, 7 Fed. Supp. 684;

Lucker v. Commissioner, 53 Fed. (2d) 418;

Ives Dairy, Inc., 23 B. T. A. 579, 65 Fed. (2d) 135.

The question is an active one and the decision in the court below adds to the confusion.

Unless reviewed, it will probably be productive of further litigation.

Conclusion.

Wherefore, it is respectfully submitted that this Petition for a Writ of Certiorari should be granted.

Respectfully submitted,

MELVIN D. WILSON,
819 Title Insurance Building,
Los Angeles, California,
Counsel for Petitioner.

October, 1937.

Certificate of Counsel.

I hereby certify that the foregoing petition is well founded and not interposed for delay.

MELVIN D. WILSON,
Counsel for Petitioner.

IN THE

SUPREME COURT

OF THE

UNITED STATES.

OCTOBER TERM, 1937.

No. .....

PACIFIC NATIONAL COMPANY,

Petitioner,

v.

GALEN H. WELCH, former Collector of Internal Revenue for the Sixth District of California,

Respondent.

BRIEF IN SUPPORT OF PETITION.

To avoid duplication, this brief is limited to argument, since the formal statements required by the rules appear *ante* as part of the Petition.

ARGUMENT.

I.

The Statute Is Permissive Only, and the Regulations Do Not Require an Election.

Section 44 of the Revenue Act of 1928 merely permits taxpayers, under certain conditions, to report sales of property on the instalment basis. It does not state that a binding election will be made if one or the other method is used. It does provide that the use of the installment basis will be subject to the conditions prescribed by the Commissioner in his regulations.

Article 353 of Regulations 74, promulgated under the Revenue Act of 1928, deals with the sale of real property on the installment plan. That regulation does not appear to contain any requirement that a binding election be made. It merely says that the vendor may use the installment method of reporting, but if he chooses, as a matter of consistent practice, to report on the accrual or cash basis, such a course is permissible.

A reading of that regulation would appear to lead one to conclude that:

1. Any qualified vendor may use the installment basis, but—

2. Only the qualified vendor who can show a consistent practice can use the accrual or cash basis.

Any election in a regulation should be carefully explained, with a statement as to the time limit for making the election, the acts deemed a definite commitment, and the consequences of the election as to the particular taxable periods and future periods.

Petitioner submits that there is no binding election in the regulation, but if there is one, it is so obscure that it should be ignored.

Since there is no election in the statute, the regulations should not be permitted to require one, unless the regulations are clear and explicit—which is not the case here.

If there is no election to prevent petitioner from using the installment basis, it should only be prevented by some general doctrine of estoppel. But it has been stipulated that no income will escape taxation if petitioner is permitted to change its basis of reporting, so no basis for estoppel exists.

II.

If There Were an Election in the Regulations, It Would Only Apply When the Method First Used Clearly Reflected Net Income.

The object of the law and regulations is to require both the taxpayer and the Commissioner to so compute the items of gross income and deductions as to clearly reflect the correct net income under all the circumstances of each case. Where the original return correctly reflects the net income, the taxpayer is ordinarily barred from subsequently choosing a more beneficial method. However, where the method originally chosen does not correctly reflect the net income, the taxpayer is not barred from subsequently using a method which does correctly reflect net income, even though the result is to lessen the tax.

This rule is well stated by the Board of Tax Appeals in *Key Largo Shores Properties, Inc.*, 21 B. T. A. 1008, 1011, as follows:

> "The respondent contends that, the petitioner having elected a particular method of reporting income, the election is binding and it cannot afterward choose a different basis. As authority for this position he cites *R. Downs, Jr.*, 5 B. T. A. 1029; Gilbert W. Lee, 6 B. T. A. 135, and other cases in which taxpayers were denied the right to change the basis of reporting income.
>
> "The cited cases either presume or decide that the method first employed by the taxpayer served to reflect the true income and proceed on the theory that in such cases it is in the interest of administrative expediency to require adherence to the method first elected. There is no doubt considerable to be said in favor of the argument made because to permit

taxpayers to change at will the basis of reporting income merely because subsequent events might produce a lower tax under one method than under another would result in an ever widening circle of confusion in the computation of taxes, with consequent delay in closing out tax cases.

"The chief foundation of the rule applied in the above cases, namely that the first elected method correctly reflected income, does not exist in the present case, as a glance at the facts will clearly show."

The Board in that case cited facts which showed that the taxpayer, selling real estate in the Florida land boom, would not be able to collect the obligations of the buyers and hence should not consider them in the computation of profit.

On page 1012, the Board further said:

"Under the Revenue Acts various methods of reporting income may be adopted by taxpayers, but all are designed to correctly reflect the true income in order that a just tax may be levied and collected. If a method used by a taxpayer does not clearly reflect income, the respondent may determine the income according to a method which in his opinion does clearly reflect it. Section 212, Revenue Act of 1926. This in itself is sufficient to demonstrate that it was not intended that taxpayers should be irrevocably bound by the election of a method of reporting when that method is erroneous. The effect in this case of requiring adherence to the basis originally adopted by the taxpayer would be to set up and tax, as income, an amount which in fact is not income. Neither administrative rules nor the forceful arguments in

favor of administrative expediency can create income where in fact there is none, and, after all, it is only income that is to be taxed. In our opinion the installment basis when applied to the facts in the present case does not reflect the taxpayer's income."

In the case at bar it is apparent from the record that the method used by petitioner did not correctly reflect the net income. Although petitioner never actually received a cent back from the trust venture throughout the time the beneficial interest in the trust was held, and the trust's correct 1928 income was less than appellant's loss from its own operations, petitioner's original return showed a net income from the trust of $137,007.17, which overcame its own loss and left a reported taxable income of $89,677.34.

Furthermore, it was readily discernible at the end of 1928 that petitioner would not get any income out of the trust.

In cases where taxpayers, in their original returns, chose methods which did not clearly reflect their income, the Board and courts have allowed them to subsequently change to methods which did reflect correct net income, although the effect was to reduce the tax. See *Morrow, Becker & Ewing, Inc., v. Commissioner,* 57 Fed. (2d) 1, 10 A. F. T. R. 1491; *McDonald v. Commissioner,* 52 Fed. (2d) 920, 10 A. F. T. R. 511; *Ives Dairy, Inc.,* 23 B. T. A. 579, 65 Fed. (2d) 135, 12 A. F. T. R. 498. For other cases in which circumstances were held warranted in relieving taxpayers of elections, but involving different types of adjustments, see *Pictorial Review Co. v. Helvering,* 68 Fed. (2d) 766, 13 A. F. T. R. 594; *Patent Royalties Corp. v. Commissioner,* 65 Fed. (2d) 580, 12 A. F. T. R. 842; *Queen City Woodworks & Lumber Co. v. Crooks,* 7 Fed.

Supp. 684, 14 A. F. T. R. 158; *Lucker v. U. S.*, 53 Fed. (2d) 418, 10 A. F. T. R. 664; *Lucas v Sterling Oil & Gas Co.*, 62 Fed. (2d) 951, 10 A. F. T. R. 255.

In *Morrow, Becker & Ewing, Inc., v. Commissioner*, 57 Fed. (2d) 1, 10 A. F. T. R. 1491, the taxpayer was selling its tract of Florida land. It sold the lots at boom prices on contract. By the end of the year some of the purchasers had defaulted and others were delinquent in payments of interest and taxes, and it was evident that the selling prices were too high. The company filed a return for 1925 on the completed basis, treating the contracts as having a value equal to their face value, and paid a tax of $35,013.43 thereon. The Revenue Act of 1926 had been passed eighteen days before the return was filed, and it permitted the installment basis of reporting where the initial payments did not exceed 25 per cent of the selling price of real property. The Regulations were promulgated some months after the return was filed. Thereafter, the company filed an amended return on the installment basis, showing a loss of $20,874.07. The Commissioner and Tax Board refused to accept the amended return. The Court held that the circumstances were sufficient to relieve taxpayer of its election. The court, on page 1493, said:

> "Taxes are assessed on income and not on honest mistakes of the taxpayer."

In the case at bar, the Revenue Act of 1928 was passed May 29, 1928, but the Regulations were not approved until February 15, 1929, and were printed and distributed

after that date. The 1928 Act permitted the use of the installment basis where the initial collections were not over 40 per cent of the selling price, whereas the 1926 Act authorized the installment basis only where the initial collections did not exceed 25 per cent of the selling price. Mr. Shelton, appellant's secretary, testified that he understood, from looking at some Regulation book, that the completed basis had to be used when the initial collections exceeded 25 per cent of the selling price [R. p. 108]. Obviously, Mr. Shelton had not yet received a copy of the Regulations promulgated under the Revenue Act of 1928, and was guided by the Regulations under the 1926 Act.

The other facts in the case at bar are similar to the facts in the above cited case, as the method originally employed in each case did not correctly reflect net income.

In *Ives Dairy, Inc.,* 23 B. T. A. 579, 65 Fed. (2d) 135, 12 A. F. T. R. 498, the taxpayer, selling land in Florida, reported on the installment basis. Before the Board of Tax Appeals it sought to change to the deferred payment basis; that is, to treat all amounts received as return of capital until the entire investment had been recovered and treat all subsequent collections as income.

The Board said (page 584):

> "Under ordinary circumstances, such a change is not permitted. We believe, however, that the principle announced in *Key Largo Shores Properties, Inc.,* 21 B. T. A. 1008, is applicable in the instant case. We there held that a taxpayer reporting an installment sale of real property might later change to the deferred payment basis when it had become

apparent during the taxable year that notes received in the transaction were worthless * * *.

"We, therefore, believe and so hold that the circumstances of the instant case justify a change as now contended by the petitioner."

The circumstances motivating the Board in allowing the change of basis, was the fact that the notes received on the sale had a face value of $177,325.00, but a fair market value of $20,000.00.

In the case at bar, also, the contracts were worth a great deal less than their face value.

In *Kaplan v. U. S.*, 18 F. Supp. 965, the Court of Claims decided a similar case. The property involved was personal property, but the law and regulations were similar. An installment sale was made, but was reported as a completed sale. Later, a claim for refund, based on the installment basis, was filed and rejected and suit brought thereon. The Commissioner defended on the ground that the taxpayer had made a binding election. The court held that there was no election in the law or Regulations. Furthermore, the contract price was reduced after the end of the taxable year, which reduced the profit. The court also held that there could be no election in any event, since the method originally used did not clearly reflect net income.

In all the cases cited by the court below, in the case at bar, the method of reporting clearly reflected net income. It is proper to hold a taxpayer to his original

choice between two correct methods, when subsequent events show that he did not choose the more favorable one. It is quite another matter to hold a taxpayer to a method which was wrong from the very beginning. In the one case, the doctrine of election prevents the taxpayer from disturbing the revenues merely for his own advantage. In the other case, the doctrine of election should not permit the Commissioner to bind the taxpayer to a mistake, and tax as income something which was not, in law or fact, income.

III.

There Can Be No Election Without a Knowledge of the Inconsistent Remedies.

Petitioner filed its return on the only method thought to be open to it. It did not know of another method which had shortly before been made available.

One of the elements of an election of remedies is that the party have knowledge of the two inconsistent remedies.

This rule seems well established, both in general law (20 *Corpus Juris* 37; *Standard Oil Company v. Hawkins,* 74 Fed. 395) and in Federal tax law (*Morrow, Becker & Ewing, Inc., v. Commissioner,* 57 F. (2d) 1).

The court below, in the case at bar, cited two Circuit Court cases to the contrary.

It would seem that the Circuit Courts are in conflict on this point also and the question should be settled by this Court.

IV.

The Question Involved Is of Such Importance That a Writ of Certiorari Should Be Granted.

In this case, the Circuit Court of Appeals has decided an important question of Federal law which has not, but should be, settled by this Court.

From the cases cited above, it is apparent that there is much litigation on the question of election of remedies in Federal tax matters, and that the Circuit Courts are in conflict and confusion over the matter.

That the decision below, unless reviewed, will cause greater confusion and be productive of more litigation, is indicated by the following comment appearing in the August 20, 1937, issue of "Alexander Tax News Letter," widely circulated:

> "CHANGE TO INSTALLMENT BASIS DENIED: COURT RULING APPEARS WRONG: Taxpayer sold realty with 25% cash deposit, balance in notes. It valued notes at market, thereby in effect using the 'deferred payment basis.' It requested permission to change to installment basis. Court denies right, concluding that when a return is filed there is a binding option, then court quotes 6 cases to that effect, as follows: Grant, 39 F. (2d) 340, Safety Prod. Co., 70 F. (2d) 439, Alameda Inv. Co., 33 F. (2d) 120, Pettigrew, 81 F. (2d) 666, Radiant Glass Co., 54 F. (2d) 718, and Moran, 67 F. (2d) 610. *Cases are not applicable.* The first and fourth involve 'joint return' of husband and wife (no change allowed beyond due

date after filing); the sixth involves estoppel, and the other three consolidated returns (no change specifically allowed by law after filing). (Pacific Natl. Co., CCA 9.)

"In Kaplan (Ct. Cls. Apr. 26, 1937) and Derbes, 69 F. (2d) 788, the courts allowed change to installment basis, where that method more truly reflected income. Installment basis is *permissive* with the taxpayer (Viault, 36 BTA No. 72—Aug. 6, 1937) and nothing whatsoever in the law prevents change to it, when income can be more truly reflected. Pacific Natl. case uses wrong precedents and should not be followed by those affected, unless and until other rulings appear."

It is therefore respectfully submitted that the Petition should be granted.

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Los Angeles, California,
Counsel for Petitioner.

October, 1937.

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APPENDIX.

Statutes and Regulations Involved.

Section 44 of the Revenue Act of 1928 provides for the filing of returns on the installment basis as follows:

"(a) *Dealers in personal property.* Under regulations prescribed by the Commissioner with the approval of the Secretary, a person who regularly sells or otherwise disposes of personal property on the installment plan may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the gross profit realized or to be realized when payment is completed, bears to the total contract price.

"(b) *Sales of realty and casual sales of personalty.* In the case (1) of a casual sale or other casual disposition of personal property (other than property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year), for a price exceeding $1,000 or (2) of a sale or other disposition of real property, if in either case the initial payments do not exceed 40 per centum of the selling price, the income may, under regulations prescribed by the Commissioner with the approval of the Secretary, be returned on the basis and in the manner above prescribed in this section. As used in this section the term 'initial payments' means the payments received in cash or property other than evidences of indebtedness of the purchaser during

the taxable period in which the sale or other disposition is made."

"(c) *Change from accrual to installment basis.* If a taxpayer entitled to the benefits of subsection (a) elects for any taxable year to report his net income on the installment basis, then in computing his income for the year of change or any subsequent year, amounts actually received during any such year on account of sales or other dispositions of property made in any prior year shall not be excluded."

Article 352, Regulations 74, promulgated under the Revenue Act of 1928, reads in part as follows:

"Art. 352. *Sale of real property involving deferred payments.* Under Section 44 deferred-payment sales of real property fall into two classes when considered with respect to the terms of sale, as follows:

"(1) Sales of property on the installment plan, that is, sales in which the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable year in which the sale is made do not exceed 40 per cent. of the selling price.

"(2) Deferred-payment sales not on the installment plan, that is, sales in which the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable year in which the sale is made exceed 40 per cent. of the selling price.

"Sales falling within class (1) and class (2) alike include (a) agreements of purchase and sale which con-

template that a conveyance is not to be made at the outset, but only after all or a substantial portion of the selling price has been paid, and (b) sales where there is an immediate transfer of title, the vendor being protected by a mortgage or other lien as to deferred payments."

Article 353, Regulations 74, reads in part as follows:

"Art. 353. *Sale of real property on installment plan.* In transactions included in class (1) in Article 352 the vendor may return as income from such transactions in any taxable year that proportion of the installment payments actually received in that year which the total profit realized or to be realized when the property is paid for bears to the total contract price.

* * * * * * * * *

"If the vendor chooses as a matter of consistent practice to return the income from installment sales on the straight accrual or cash receipts and disbursements basis, such a course is permissible, and the sales will be treated as deferred-payment sales not on the installment plan."

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1937.

No. 528.

PACIFIC NATIONAL COMPANY, *Petitioner*,

v.

GALEN H. WELCH, Former Collector of Internal Revenue for the Sixth District of California, *Respondent*.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit.

BRIEF FOR THE PETITIONER.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1937.

No. 528.

PACIFIC NATIONAL COMPANY, *Petitioner*,

v.

ALEN H. WELCH, Former Collector of Internal Revenue for the Sixth District of California, *Respondent*.

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n Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit.

BRIEF FOR THE PETITIONER.

OPINION BELOW.

The District Court filed no opinion. Its findings of fact pecial) and conclusions of law appear at R. 23-30. The inion of the Circuit Court of Appeals (R. 198) is reported 91 F. (2d) 590.

JURISDICTION.

The judgment of the Circuit Court of Appeals was en- red August 2, 1937 (R. 207). The petition for a writ of rtiorari was filed October 5, 1937, and was granted De- mber 6, 1937. The jurisdiction of this Court is conferred Section 240(a) of the Judicial Code, as amended by the ct of February 13, 1925.

QUESTIONS PRESENTED.

1. When a taxpayer, through ignorance of a right to use any other basis, files its 1928 return on a basis which does not clearly reflect its net income, is it bound by the method so used?

2. Was petitioner or Trust No. P. T. 46 the proper entity to report the operations of the subdivision venture?

STATUTES AND TREASURY REGULATIONS INVOLVED.

The statutes and Treasury regulations involved will be found in the Appendix, *infra*, pp. 34-41.

STATEMENT.

The case was tried, without a jury (R. 22), before the District Court of the United States for the Southern District of California, Central Division. Special findings of fact were requested (R. 159-178) and errors were assigned on appeal below regarding the failure of the District Court to find numerous material facts (R. 183-188). The Circuit Court of Appeals summarized much of the evidence in its opinion (R. 199-205), but decided against petitioner on a proposition of law. The principal facts, shown from the Bill of Exceptions (R. 37-181), are as follows:

Petitioner, which was primarily a holding company for stocks of certain banks (R. 110), purchased in 1927 a tract of land in Culver City, Los Angeles County, California, for $609,000.00, of which $309,000.00 was paid in cash. Five notes, aggregating $300,000.00, were given by petitioner to the seller to cover the remainder of the purchase price and the properties were conveyed to the Pacific National Bank, as Trustee of Trust No. P. T. 46 (R. 44, 68-93).

Under this indenture the Trustee was to execute all contracts of sales for the lots (R. 82), to receive initial and installment payments and to apply the sums so received to (1) expenses of the trust; (2) expenses of subdividing, improv-

ing and selling the lots; (3) a fund to amortize the notes; and (4) the balance, if any, to petitioner (R. 83-84). After the notes had been amortized, the trust was to continue for petitioner's benefit (R. 84), but for a period not exceeding twenty years (R. 90).

Pursuant to the trust indenture, the Trustee caused the property to be platted and subdivided and arranged for the sales of subdivision lots by one Elwell, an experienced real estate agent (R. 115, 141-142). It developed that an error had been made as to the area acquired, and Elwell tried with but little success to sell the lots at high enough prices to return the sum originally intended to be secured from the venture (R. 116-117). One Brick solicited the Trustee for an opportunity to sell the lots and was employed by petitioner (R. 117, 44) as exclusive selling agent. Under the selling contract (R. 54-67) Brick was to secure minimum prices (R. 61-67) which greatly exceeded those regarded by Elwell as reasonable (R. 116, 117), and was to receive commissions of 35 per cent and more for his services (R. 57-60).

The lots were to be sold for initial payments of not less than 25 per cent of the total selling prices, the balances of such prices being payable in monthly, quarterly or semi-annual installments over periods not exceeding five years from the dates of sales (R. 55-56).

Brick used the "lunch and lecture" method of selling lots (R. 117), and by December 31, 1928, had sold 257 lots for prices amounting in the aggregate to $838,026.25 (R. 144). Of these, 13 were cash sales for an aggregate price of $41,144.25 (R. 143). The installment sales were made for initial payments of about 25 per cent of the selling prices (R. 108). By December 31, 1928, 16 accounts, amounting to $35,274.51, had been cancelled and 92 accounts, or 40 per cent of the total number of accounts, were delinquent. These delinquent accounts amounted to $201,674.56, which was 38 per cent of the total of the unpaid accounts (R. 143).

Petitioner's 1928 income tax return was prepared by its secretary, who was an inexperienced young man (R. 107),

who got the data concerning sales of subdivision lots from the Trustee of Trust No. P. T. 46 (R. 112). On the tax return the transactions for both 1927 and 1928 were included and the taxable income was arrived at as if petitioner had sold the lots (R. 108, 111).

The secretary was ignorant of all of the permissible methods of determining income from sales on the deferred payment plan (R. 108), and apparently believed that the entries made upon books kept by him wholly governed the amounts of income to be reported in the tax return (R. 111).

Upon petitioner's books and in the return the sales were treated as completed sales and the purchaser obligations were treated as being the equivalent of cash (R. 43, 108, 111, 119). By this treatment of the sales of subdivision lots, income from that venture in the sum of $137,007.17 was shown as received by petitioner (R. 42-43). Petitioner in fact received no cash distributions from the trust in 1928, and paid some $50,000.00 into the trust to reduce the debt to the original seller of the land (R. 112). Such benefits as petitioner derived from the operations were the amounts out of the various installments which were applied by the Trustee on the purchase money notes. In December, 1931, petitioner disposed of its beneficial interest in Trust No. P. T. 46, in partial settlement of a guaranty obligation to the Transamerica Corporation, and at that time over $100,000.00 was still owed on the purchase money notes (R. 123, 124).

Petitioner by a timely claim for refund (R. 41) sought a redetermination of income from the real estate venture upon the installment basis (R. 47, 48), and by an amended claim for refund (R. 41) filed after the period of limitations, but while the first claim was under consideration, asserted the additional ground that Trust No. P. T. 46, and not petitioner, should have made the return of income from the real estate venture (R. 51-52). The refund claims were rejected, except as to items not here involved (R. 27, 28, 42), and suit for a refund was instituted in the District Court.

On January 3, 1935 (which was after the initiation of the

suit), the then Trustee of Trust No. P. T. 46 filed delinquent fiduciary returns for the trust (R. 43, 121-122). These returns treated the deferred payment sales of lots as sales on the installment plan (R. 148, 153). Upon application of the installment basis, the aggregate income from the venture for the years 1927 and 1928 amounted to $44,048.10, and the income distributable to petitioner, after various deductions, was $19,894.89 for the combined periods (R. 146, 151).

It was stipulated in the trial court that there would be some amount of refund due if petitioner is entitled to have the sales of lots treated as installment sales, and that no income would escape taxation in subsequent years by reason of the statute of limitations if the income for 1928 is determined upon the installment basis (R. 118).

It was stipulated in the trial court that if petitioner prevails in its contention that it is entitled to a redetermination of its tax, the matter may be referred back to the parties for agreement and that if the parties are unable to agree, each shall submit his computation to court and shall have the right to introduce further evidence as to necessary figures (R. 44-45).

SPECIFICATIONS OF ERROR TO BE URGED.

The Circuit Court of Appeals erred in holding that the use of a method of reporting income which did not correctly reflect income, through ignorance of the statutory methods authorized to be used, constituted a binding election, estopping petitioner from using a statutory method which does correctly reflect net income.

The Circuit Court of Appeals erred in failing to decide that, although Trust No. P. T. 46 was not in 1928 an association taxable as a corporation, it nevertheless was the taxable entity required by law to report the income from the real estate venture, and that petitioner's income was overstated to the extent that it exceeded petitioner's distributable share of the net incomes from the trust, determined on the installment basis.

SUMMARY OF ARGUMENT.

Petitioner seeks correction of an erroneous overstatement of income which petitioner made, in its 1928 income tax return, as representing the amount of gain or profit realized by it in 1928 from the installment-plan sales of subdivision lots by Trust No. P. T. 46, of which petitioner was beneficiary. To reflect clearly the income from these contracts, the income should be calculated on the installment basis specifically provided for in the law. The terms and the circumstances surrounding the sales make this plain. When the income is so calculated it is stipulated that some refund results.

The error made by taxpayer was not a mere error in choosing between two permissible courses of reporting income; the overstatement of tax was due to the use of figures which did not reflect income and were not in accordance with any prescribed or permissible method of calculating income. The normal method, in the case of installment-plan sales, was the installment basis now contended for; the only other permissible basis was a method in which the fair market value of the installment obligations would be determined and the sale treated as closed at that value in the taxable year. Petitioner followed neither of these methods. Being ignorant of both, it treated the sales as if they had been sales for cash at the figures mentioned in the contracts.

Petitioner's error was an honest mistake; taxpayers who make such mistakes are permitted under the income tax law to have them corrected if they do not permit their rights to be barred by a statute of limitations. No such bar is here involved.

Both of the lower courts misconceived the tax law as providing that in the circumstances of this case petitioner made a binding election, preventing later correction of its error. In so doing, they confused the situation existing in this case with the instances in which taxpayers chose and actually applied one or the other of the permissible methods mentioned above, under such circumstances that either method

would clearly reflect the income. Neither the law nor the regulations support the conclusion that the error made by petitioner must stand uncorrected, and as a matter of law no administrative discretion exists in the Commissioner of Internal Revenue, on such facts as here appear, warranting the decisions below. Nor is any element of estoppel involved.

If petitioner was further wrong in making its return as if the trust were merely petitioner's agent (rather than as if the petitioner was a beneficiary of a business trust such that beneficiaries report only income distributable to them), it nevertheless remains true that the income from these sales should be calculated on the installment basis provided in Section 44 of the Revenue Act of 1928.

ARGUMENT.

I.

The Installment Basis Alone Reflects Income from the Real Estate Venture.

This portion of the argument refers to the petitioner herein as if it were actually the seller of the lots in question—following the theory that when the sales were made by the Pacific National Bank, Trustee of Trust No. P. T. 46, the trust was to be treated as a direct agent for petitioner. An argument that the real taxable entity here was the trust, not the petitioner, and that for tax purposes this petitioner is to be treated merely as a beneficiary of a trust, is presented herein beginning at page 26. Whichever of these theories is accepted, the installment basis (actually used by the trustee in making delinquent returns for the trust (R. 121, 148, 151)) is the proper basis, as argued in this brief.

A. The installment basis was the right method under the facts and the law.

The real estate subdivision venture was initiated in the fall of 1927 and its operations for that year and for the entire year 1928 were reflected for the first time in the tax return of petitioner for the taxable year 1928 (R. 108). Approximately 95 per cent of the lots sold by petitioner to December 31, 1928 were on the installment plan (R. 143), and in most instances the initial payments were 25 per cent of the selling prices (R. 108), which was the minimum down payment specified in the contract with the selling agent (R. 55).

The Revenue Act of 1928 (Appendix, pp. 34-35) contains an express provision as to how sales on the installment plan of precisely this type may be treated. In Section 44 it is provided that in the case of a sale of real property, if the initial payments do not exceed forty per cent of the selling price, "the income may, under regulations prescribed by the Commissioner with the approval of the Secretary", be returned on the so-called "installment basis", under which a person who sells property

> "may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the gross profit realized or to be realized when payment is completed, bears to the total contract price."

The regulations prescribed by the Commissioner with the approval of the Secretary, under the authority of this section, are found in Articles 352 to 354, of Treasury Regulations 74 (Appendix, pp. 36-38). They impose no limitations on the privilege granted in that section. Under these regulations, just as under the provisions of Section 44, this taxpayer was granted the privilege of having its income from the real estate venture determined on the installment basis above outlined, and this is the privilege which the taxpayer now seeks. The Commissioner has declined to grant the taxpayer this privilege.

The respondent's defense of the Commissioner's conduct in refusing to permit this taxpayer the privilege thus granted in the law is that the taxpayer in making its return has precluded itself from using the installment basis, by the way income was reported on the return. We submit that this position is not based on anything contained in the Commissioner's regulations, which contain no suggestion that a taxpayer who makes an erroneous return is thereafter prevented from having the error corrected. Nor do the regulations provide that a taxpayer desiring to take advantage of the privilege granted him in Section 44 can exercise that privilege only at the time of filing his original return. The regulations (Art. 322) do provide that a taxpayer who has once adopted an installment basis or a noninstallment basis must adhere to the method he chose until the Commissioner grants him the privilege of changing it, but that provision of the regulations, relating to changes from one permissible basis to another permissible basis, has no relation to a case like this in which, prior to the year 1928, the taxpayer had had no occasion to make a choice, and in which (as shown *post*, pp. 10-13) the taxpayer's original 1928 return was simply erroneous and the tax not calculated on any permissible basis.

The Commissioner's refusal to permit the use by petitioner of the installment basis was contrary to interpretations of the statute and the regulations, as applied to similar situations, by the courts and by the Board of Tax Appeals. Compare *Morrow, Becker & Ewing, Inc.* v. *Commissioner*, 57 F. (2d) 1 (C. C. A. 5th); *Kaplan* v. *United States*, 18 F. Supp. 965, 967 (Ct. Cls.); *Key Largo Shores Properties, Inc.* v. *Commissioner*, 21 B. T. A. 1008, 1012; *Ives Dairy, Inc.* v. *Commissioner*, 23 B. T. A. 579, 584, affirmed 65 F. (2d) 135 (C. C. A. 5th), hereinafter discussed (*post*, pp. 17-20).

The United States Court of Claims in the case of *Kaplan* v. *United States*, 18 F. Supp. 965, 967, involving a casual sale of personal property, but otherwise analogous to the

facts of this case, permitted a refund to be recovered upon application of the installment sales method of accounting, and held that no binding *choice* resulted from the fact that the petitioner had filed his tax return on the basis of a completed sale. The Court disposed of a contention that the words "may return" used in Section 44(a) of the Revenue Act of 1928 imported a "binding election" as follows (at page 968):

> "* * * It is clear that the words 'may return' were used to permit the large number of taxpayers engaged in the installment-sales business to use either the accrual method or the installment-sales method of reporting income, and even where the former is used the statute permits a change to the installment method. The regulations do not so much as imply that a choice of computing profit on one or the other method in reporting a casual sale of property shall be construed as a binding election. The statute gives the Commissioner no discretionary power to reject a timely claim for refund or to refuse to compute a taxpayer's income in a case like the one at bar where the taxpayer on the cash receipts and disbursements basis receives in the taxable year less than 40 per cent. of the sales price under an installment-sales contract. * * *"

B. Petitioner's return was wrong in fact and not in accordance with the law or regulations.

The officer who prepared petitioner's 1928 income tax return was inexperienced in such matters (R. 107) and had a number of erroneous conceptions of what the law and regulations required in that connection. One erroneous view was that, because the books, also kept by him, had carried the purchaser obligations at face values and were otherwise on a strict receipts and disbursements basis, it was necessary for him to treat the sales as completed or cash sales and the purchaser obligations as the equivalent of cash at par in preparing the tax return (R. 108, 111). Neither the law nor the regulations authorized what he did.

Under general principles governing the determination of income from an exchange of property for cash and obligations of a purchaser, it is necessary to compare the "basis" for the property with the sum of "any money received plus the fair market value of the property (other than money) received" (Sec. 111(a) and (c), Rev. Act 1928).[1] In petitioner's sales of subdivision lots the "properties" to be valued were the purchaser obligations (Regs. 74, Arts. 353-354).[2]

Determinations of the fair market values of purchaser obligations are required in the case of installment sales of real estate whether the obligations are represented by promissory notes or, as here, merely by contracts to make future payments. Compare G. C. M. 3350, VII-1 C. B. p. 62; O. D. 842, 4 C. B. p. 89.

In cases where it appears that the purchaser obligations have no fair market values, the sales are not treated as "closed". Instead, the installment payments are used to reduce the "basis" for the properties sold and no income is to be accounted for until the capital investment has been recovered. Compare *Georgia-Florida Land Company* v. *Commissioner*, 16 B. T. A. 1253, 1259; *Ives Dairy, Inc.* v. *Commissioner*, 23 B. T. A. 579, affirmed 65 F. (2d) 135 (C. C.

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[1] Sec. 111(c), Rev. Act 1928, provides:

> "*Amount realized.*—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received."

[2] Art. 353 (Appendix, pp. 37-38) provides that if a taxpayer uses the receipts and disbursements basis, or the straight accrual basis, instead of the installment basis, then income from installment sales shall be determined as in the case of "deferred-payment sales not on the installment plan." Art. 354 prescribes the procedure in such cases as follows:

> "In transactions included in class (2) in article 352, the obligations of the purchaser received by the vendor are to be considered as the equivalent of cash *to the amount of their fair market value* in ascertaining the profit or loss from the transaction." (Italics supplied)

A. 5th); *Biscayne Bay Islands Company* v. *Commissioner*, 23 B. T. A. 731, 735-736; *Burnet* v. *Logan*, 283 U. S. 404.

It is thus plain that sales of real estate on the deferred payment plan may be treated as "closed" or completed sales only (a) where the installment obligations have fair market values at the times when the contracts are received by the vendor; and (b) where those fair market values have been determined by the taxpayer and used in determining income from each sale.

The officer who prepared petitioner's return did not know that the installment basis was available, nor did he know that if the installment basis was not used the regulations required that the sales contracts be set up at their fair market values (R. 108). The officer got his impressions as to what was required from some book of regulations (R. 108). Since Treasury Regulations 74, containing the information (Art. 352) that sales with initial payments not exceeding 40 per cent of selling prices could be treated as installment sales, were not approved by the Secretary of the Treasury until February 15, 1929 (Regs. 74, p. 344), which was only thirty days before petitioner's tax return was filed (R. 41), it is reasonable to suppose that those regulations were not at hand. In *Morrow, Becker & Ewing, Inc.* v. *Commissioner*, 57 F. (2d) 1 (C. C. A. 5th), lack of access to Treasury regulations was held material in determining whether a change to the installment basis was permissible after a return employing another basis had been filed.

In any event, it is plain that petitioner's return was not in accordance with *any* procedure authorized by the regulations and was simply an erroneous return.[3]

Even in cases where *elections* are required as between two different kinds of tax returns, it seems generally recognized that the choice must have been voluntary and definite and

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[3] Error on the part of the District Court in concluding (R. 29) that the return was in accordance with the law and regulations was duly assigned (R. 184) and that question was thus before the court below.

the method of return selected a valid and proper one. *Commissioner* v. *Union Pacific Railroad Co.*, 86 F. (2d) 637, 639 (C. C. A. 2nd); *Lucas* v. *Sterling Oil & Gas Co.*, 62 F. (2d) 951, 952 (C. C. A. 6th); *Pictorial Review Co.* v. *Helvering*, 68 F. (2d) 766, 768-769 (App. D. C.), distinguishing *Radiant Glass Company* v. *Burnet*, 54 F. (2d) 718, 719 (App. D. C.); *Patent Royalties Corp.* v. *Commissioner*, 65 F. (2d) 580, 581 (C. C. A. 2nd); *McIntosh* v. *Wilkinson*, 36 F. (2d) 807, 808 (D. C. Wis.); *Queen City Woodworks & Lumber Co.* v. *Crooks*, 7 F. Supp. 684, 685 (D. C. Mo.).

C. The installment basis will most clearly reflect income from the sales involved.

The installment sales in this case were at high prices (R. 61-67, 117), and the lots were sold by "lunch and lecture" methods (R. 110, 117) by an agent whose commissions, according to the contract of employment (R. 55), began at 35 per cent of the selling prices (R. 57-59).

Two hundred and fifty-seven lots had been sold by December 31, 1928, the first full year of the venture, and the total of the contract prices was $838,026.25 (R. 144). Of these, 13 were cash sales for an aggregate consideration of $41,144.25. At December 31st, 16 accounts, amounting to $35,274.51, had been cancelled and there remained on the books 228 accounts, having an aggregate unpaid balance of $525,436.94. Of these accounts, 40 per cent in number and 38 per cent in amount, totaling $201,674.56, were delinquent (R. 143).

When it is considered, in addition to the foregoing, that most of the sales were at initial payments of only about 25 per cent of the selling prices and that the delinquencies occurred before the end of the first year of the venture,[4] it becomes apparent that petitioner's return was wholly erroneous *on the basis of the facts*, in treating the sales as cash

[4] Only 14 sales occurred in 1927 (R. 144), and were included in the 1928 tax return (R. 108).

sales or completed sales in which the unpaid obligations of purchasers were the equivalent of cash (R. 108)..

Petitioner acquired the land which was subdivided for a total consideration of $609,000.00, of which $309,000.00 was paid in cash and the balance of $300,000.00 was represented by five of petitioner's notes, payable over a period ending July 15, 1931 (R. 69-72). In connection with the total sales of $838,026.25 to December 31, 1928, selling commissions of $273,711.30 were incurred. The costs of the lots (allocated upon the basis of selling prices (R. 108)) amounted to $445,344.90, leaving a gross profit to be realized, *if all of the obligations were fully paid*, $118,954.05 (R. 144).

Since, however, 38 per cent in amount of the unpaid obligations, amounting to $201,674.56 (R. 143), were delinquent at December 31, 1928, it would be necessary to assume, in concluding that any income whatever would result from the venture, (1) that those unpaid obligations not delinquent in 1928 would be paid in full; and (2) that $82,720.51,[5] or an average of over 40 per cent of the face amounts of the delinquent accounts, would ultimately be paid before *any* profit or income from the venture would be realized by petitioner.

The facts stated above show beyond question, it is submitted, that many of the purchaser obligations would not be paid in full. This is corroborated by the fact that petitioner found it necessary to pay into the trust about $50,000.00 of new money to be applied on the purchase money debt in 1928 (R. 112), and that when petitioner disposed of its beneficial interest in the venture in December, 1931 (R. 123), there was still over $100,000.00 due on that debt (R. 124), which under the planned program of the venture, as reflected by the Trust Agreement (R. 68, 83-84),

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[5] This amount is the difference between the total possible profit and the amount of the delinquent accounts at December 31, 1928, and gives no effect to the probability that other accounts would become delinquent or wholly uncollectible.

should have been wholly paid by July 15, 1931, when the last of the purchase money notes became due (R. 72).

Under the facts of this case the only reasonable or proper method of determining income was the installment basis authorized by Section 44 of the 1928 Act, under which part of each installment, as and when actually received, would be allocated to capital and a part to gain. The amount so determined to be gain would approximate the amounts actually paid to petitioner by the trust, or applied for petitioner's benefit upon the purchase money notes.

D. The statute, regulations and precedents support petitioner's right to use the installment basis.

The Treasury Department since the Revenue Act of 1917 has recognized in its regulations[6] that income from installment sales where small initial payments were involved would be most clearly reflected by having the recognition of income keyed to, and dependent upon, the actual receipt of installment payments, and has permitted the use of the installment basis principle with only minor variations since that time. This was in order to give some alleviation from the hardships involved in the application of the cash or accrual basis of determining income. *Burnet* v. *S. & L. Building Corporation*, 288 U. S. 406, 413.

Doubt having been cast by the Board of Tax Appeals upon the validity of the Treasury regulations allowing the use of the installment basis, Congress in the Revenue Act of 1926 (c. 27, 44 Stat. 9, Sec. 212(d)) made specific provisions for the use of the installment basis. Its broad purpose is reflected by the following quotation from Senate Report No. 52, 69th Congress, 1st Session, at page 19:

> "The application of the installment basis as provided in the committee amendment should eliminate necessity for appraisals of the obligations of the purchaser in

[6] Treasury Regs. 33, Art. 117; Regs. 45, Arts. 44, 45; Regs. 62, Arts. 44, 45; Regs. 65, Arts. 44, 45.

> deferred-payment sales, as required under the Board of Tax Appeals decisions, save in those cases where, because of a large initial payment, i. e., one in excess of 25 per cent of the price, the property sold and serving as security for the unpaid balance has a value adequate to give the obligations a market value."

In the 1928 Act Congress, by Section 44(b), liberalized the definition of an "installment sale" so as to include sales in which initial payments did not exceed 40 per cent of the selling prices. This was explained in Senate Report No. 960, 70th Congress, 1st Session, at page 22, where it was said:

> "* * * It was believed that the 25 per cent limitation in the 1926 act forced the reporting on the accrual basis of sales in which the initial payment, though larger than 25 per cent, was insufficient to create *a substantial assurance of the actual payment of the full amount of the deferred purchase price.*" (Italics supplied)

It seems significant in this connection that Regulations 74, Article 353, treats the installment basis as the one ordinarily to be used, and the use of another basis is merely said to be "permissible" under special conditions.[7]

The decision of the Circuit Court of Appeals, which reviewed most of the foregoing evidence in its opinion (R. 199-205), that petitioner was bound by its original tax return, necessarily ascribed to the Commissioner powers which he did not have under the law applicable to this case.

It may be assumed that there sometimes exists, even in the absence of statutory provisions or notice by regulations, power on the part of the Commissioner of Internal Reve-

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[7] Art. 353 provides in this connection as follows:

> "If the vendor chooses as a matter of consistent practice to return the income from installment sales on the straight accrual or cash receipts and disbursements basis, such a course is permissible, and the sales will be treated as deferred-payment sales not on the installment plan."

nue to refuse to permit a maker of installment sales to adopt the installment basis after having filed a return in which the income from such sales was determined upon another proper basis. However, petitioner submits, upon principle, and upon authority of the cases hereafter discussed, that the existence of such discretion depends *as a matter of law* upon the existence of circumstances not found in this case. These are:

1. The original determination of income in the tax return must have been in accordance with specific provisions of the law and the regulations.

2. The basis employed in the return must be one which clearly reflects income in the particular situation dealt with.

Petitioner's case is quite similar on the facts to the case of *Morrow, Becker & Ewing, Inc.* v. *Commissioner,* 57 F. (2d) 1, 2 (C. C. A. 5th). In that case, as here, a single subdivision venture was involved and most of the lots were sold on an installment plan. In the majority of sales the initial payment did not exceed one-fourth of the sales price. The subdivision was in Florida, and by the end of the first year (1925), land prices in the vicinity had dropped considerably and defaults had occurred in respect of 62 out of a total of 305 contracts. The taxpayer filed its return for the year 1925, shortly after the enactment of the Revenue Act of 1926 permitting the use of the installment basis, but before Treasury regulations were available. That return included all sales, whether cash or installment, as one item and made deductions based upon the venture as a whole. Upon learning of the installment sales provisions in the Revenue Act of 1926, the taxpayer filed an amended return which the Commissioner refused to recognize. Of this refusal the Circuit Court of Appeals said (at page 2):

> "While there is no statutory authority for an amended return, amended returns are frequently per-

mitted, and they are sometimes required by the Commissioner. In fact, the Commissioner has authority to make them when a taxpayer neglects or declines to do so. The case presented is not one where, the law being well settled, the taxpayer had elected to keep his books on a certain basis and to make returns accordingly and had afterwards attempted to change the method of accounting or the basis of the return. In that case it would, of course, be proper to hold him estopped, as an orderly administration of the revenue laws would be otherwise impossible. In this case the Commissioner put his refusal to allow the amended return on the ground that petitioner had chosen the installment basis for reporting profits and could not change. This gave no effect to changes in the law and regulations occurring afterwards. In view of the radical changes in the law, of which the petitioner had scant notice, if any, in fairness and justice to the taxpayer the returns should have been received and considered. Taxes are assessed on income and not on honest mistakes of the taxpayer. It was the duty of the Commissioner to do nothing arbitrary or unreasonable that would deprive petitioner of rights created by the new law and the regulations thereunder. It was a breach of discretion on the part of the Commissioner not to receive the amended return from 1925 under the circumstances disclosed."

Similar changes of basis have been permitted by the Board of Tax Appeals in *Key Largo Shores Properties, Inc.* v. *Commissioner*, 21 B. T. A. 1008, 1012, and *Ives Dairy, Inc.* v. *Commissioner*, 23 B. T. A. 579, 584, affirmed 65 F. (2d) 135 (C. C. A. 5th), cases where taxpayers, having filed returns reflecting sales of real estate subdivision properties by use of the installment method, were permitted to change to the deferred payment method because it appeared that the obligations of the purchasers were in fact worthless and that the method originally used did not reflect the income. In the case of *Key Largo Shores Properties, Inc.*, the Board distinguished certain of its earlier decisions where changes to or from the installment method were held not permissible as follows (at page 1011):

"The cited cases either presume or decide that the method first employed by the taxpayer served to reflect the true income and proceed on the theory that in such cases it is in the interest of administrative expediency to require adherence to the method first elected."[8]

The Board stated the basis for its decision that Key Largo Shores Properties, Inc., was not bound by its original return as follows (at page 1012):

"Under the Revenue Acts various methods of reporting income may be adopted by taxpayers, but all are designed to correctly reflect the true income in order that a just tax may be levied and collected. If a method used by a taxpayer does not clearly reflect income, the respondent may determine the income according to a method which in his opinion does clearly reflect it. Section 212, Revenue Act of 1926. This in itself is sufficient to demonstrate that it was not intended that taxpayers should be irrevocably bound by the election of a method of reporting when that method is erroneous. The effect in this case of requiring adherence to the basis originally adopted by the taxpayer would be to set up and tax, as income, an amount which in fact is not income. Neither administrative rules nor the forceful arguments in favor of administrative expediency can create income where in fact there is none, and, after all, it is only income that is to be taxed. In our opinion the installment basis when applied to the facts in the present case does not reflect the taxpayer's income."

In *Kaplan* v. *United States*, 18 F. Supp. 965, 967-968, the Court of Claims allowed a refund predicated upon a redetermination of income from installment sales of personal property (also governed by Section 44(b) of the Revenue Act of 1928) through the application of the installment sales meth-

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[8] *Strauss* v. *Commissioner*, 33 B. T. A. 855, affirmed *per curiam* 87 F. (2d) 1018 (C. C. A. 2nd); *Rundel* v. *Commissioner*, 21 B. T. A. 1019; *Johnson Realty Trust* v. *Commissioner*, 21 B. T. A. 1333; *Ellis* v. *Commissioner*, 16 B. T. A. 1225; *Viault* v. *Commissioner*; 36 B. T. A. 430, cited by respondent in the Brief in Opposition (p. 7), all involve conclusions or assumptions that the basis first used did reflect income.

od, over the objection that the use of a different method in the original tax return constituted an election of method which must stand. After holding that the law imposed no duty to make an election, the Court pointed out that the method used in the tax return would not reflect income by reason of events which had occurred after the close of the tax year, but before the Commissioner rejected the taxpayer's claim for refund.

Petitioner in the instant case in December, 1931, assigned its beneficial interest in the trust to a nominee of the Transamerica Corporation in partial settlement of a guaranty obligation to that company (R. 123-124). At that time there was still an incumbrance of $100,000.00 on the trust property (R. 124), and it may reasonably be inferred that petitioner ultimately sustained a loss from its participation in the venture.

There is not here involved any of the situations which existed in the cases cited by the Circuit Court of Appeals in its opinion (R. 206) as authority for the proposition that the Revenue Act of 1928 required petitioner, at the time of filing its 1928 tax return, to make a final and irrevocable election to use or not to use the installment basis for determining income from its real estate venture. Those cases[9]

[9] The cases cited by the court below and by respondent in his brief in opposition to the writ (pp. 6-7) involved (a) efforts by affiliated corporations, after the time limit for filing tax returns, to change either to or from separate or consolidated corporation income tax returns (*Alameda Investment Company* v. *McLaughlin*, 33 F. (2d) 120 (C. C. A. 9th); *Radiant Glass Company* v. *Burnet*, 54 F. (2d) 718, 719 (App. D. C.); *Safety Electric Products Co., Inc.* v. *Helvering*, 70 F. (2d) 439, 441 (C. C. A. 9th); *Dr. Pepper Bottling Co.* v. *Commissioner*, 69 F. (2d) 768 (C. C. A. 5th); *Lucas* v. *St. Louis National Baseball Club*, 42 F. (2d) 984 (C. C. A. 8th), certiorari denied 282 U. S. 883); or (b) efforts of married persons to make belated changes to or from separate or joint individual income tax returns (*Rose* v. *Grant*, 39 F. (2d) 340, 341 (C. C. A. 5th); *Buttolph* v. *Commissioner*, 29 F. (2d) 695, 696 (C. C. A. 7th); *United States* v. *Pettigrew*, 81 F. (2d) 666, 667 (C. C. A. 9th); *Morris* v. *Commissioner*, 40 F. (2d) 504 (C. C. A. 2nd); *Anderson* v. *United States*, 48 F. (2d) 201 (C. C. A. 5th)). Compare *McIntosh* v. *Wilkinson*, 36 F. (2d) 807 (D. C. Wis.).

(with one exception)[10] involved efforts by taxpayers to change from one authorized kind of complete tax return to another kind of return *after the special period of limitations* prescribed by law for the filing of tax returns had expired.

Petitioner's failure to determine income from the sales of subdivision lots on the installment basis in its return for 1928 (which was the initial year for determining income from such sales), is to be treated no differently than other common errors of taxpayers such as the failure in preparing a tax return to take a statutory deduction or allowance. Corrections of such errors are expressly authorized, provided (as is here the case) a proper and timely claim for refund is filed, asking that the taxable income be redetermined on the proper basis. (Sec. 322, Rev. Act 1928; and Sec. 3220, Revised Statutes, as amended by Sec. 1111, Rev. Act 1926, and by Sec. 619, Rev. Act 1928 (Appendix, pp. 35-36).)

Petitioner submits that Congress has placed no special limitations upon the period in which a taxpayer making sales which fall within the scope of Section 44(b) of the Revenue Act of 1928, may correct a failure to use the installment basis for determining income, and that to imply a special period of limitations would work an unauthorized and illegal departure from an important and fundamental feature of that system of corrective justice which Congress has provided as a part of its revenue system. *Cheatham* v. *United States*, 92 U. S. 85; *Snyder* v. *Marks*, 109 U. S. 189, 193; *Graham* v. *Dupont*, 262 U. S. 234, 255.

In addition, the interpretation of the law by the court below defeats the purpose of the statute and regulations to alleviate the hardships involved in the use of the cash or accrual methods of determining income from installment sales (*Burnet* v. *S. & L. Building Corporation*, 288 U. S. 406, 413),

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[10] *Moran* v. *Commissioner*, 67 F. (2d) 601 (C. C. A. 1st), involved an attempt to change from a position taken in earlier tax years to a new position injurious to the public revenues, and turned upon the issue of estoppel.

and is not to be so narrowed by judicial construction (*Helvering* v. *Stockholms Enskilda Bank*, 293 U. S. 83, 93-94; *Gould* v. *Gould*, 245 U. S. 151; *United States* v. *Merriam*, 263 U. S. 179).

E. Petitioner's book entries are not controlling.

Petitioner's books erroneously reflected the installment sales as if they were cash sales (R. 108). They did not purport to reflect fair market values of the installment obligations (R. 108, 119), and hence were not kept upon the basis of "deferred-payment sales not on the installment plan" as contemplated by Regulations 74, Articles 353-354.

The Circuit Court of Appeals seems to have concluded (R. 205-206) that, because the 1928 tax return showed income from the real estate venture in accordance with petitioner's book entries, the return was necessarily a proper and binding one. Book entries are not controlling in Federal tax matters as this Court has often recognized. *Doyle* v. *Mitchell Brothers Company*, 247 U. S. 179, 187; *United States* v. *Anderson*, 269 U. S. 422, 442-443; *American National Co.* v. *United States*, 274 U. S. 99, 105; *Lucas* v. *American Code Co.*, 280 U. S. 445, 449.

In *Commissioner* v. *Union Pacific Railroad Company*, 86 F. (2d) 637 (C. C. A. 2nd), the Circuit Court of Appeals disposed of a contention that a taxpayer's method of recording certain deferred payment sales upon its books was controlling as to how income therefrom should be computed, as follows (at page 639):

> "The petitioner contends that there was no evidence that these items were accrued on the respondent's books. But that fact is immaterial; actual bookkeeping entries do not control in the determination of the question of whether an item is income or deductible on an accrual basis, but the facts do."

It has not been suggested that petitioner's books do not permit a determination of income upon the installment basis, and the delinquent returns of the Trustee (R. 145, 149), which presumably were made from those books[11] (R. 119) and which employed the installment basis (R. 148, 153), demonstrate that the books are entirely adequate in that respect. The total profits chargeable to petitioner from operations of the subdivision to December 31, 1928, as reflected by the two delinquent returns of the trust, were $44,048.10 (R. 148, 153) and were subject to some reductions for interest, taxes and expenses (R. 150). Petitioner's determination of $137,007.17, reflected in its tax return for 1928, was grossly excessive under any view of the case.

F. No grounds for estoppel exist and no administrative burden is involved in petitioner's use of the installment basis.

The stipulation (R. 118) that no revenues will be lost to the United States by reason of the statute of limitations, if petitioner is permitted to use the installment basis, clearly disposes of any reasonable basis upon which a defense of estoppel could be founded, and that defense (although apparently raised by the Commissioner (R. 51, 52)) has not in fact been asserted by the respondent. *Helvering* v. *Salvage*, 297 U. S. 106, 109.

The suggestion made by respondent (Brief in Opposition, p. 9), and by the District Court below (R. 29), that the failure to ascertain the market values of the obligations of purchasers of the subdivision lots was merely a procedural error which might have been corrected within the scope of the "deferred-payment sales not on the install-

[11] The testimony fails to state that the returns are from petitioner's books (R. 121); however, the data corresponds, except for minor variations, with data (Petitioner's Exhibit No. 10, R. 144) which were made from the books and records of Trust No. P. T. 46 (R. 120), which records were the sources for petitioner's book entries (R. 112).

ment basis'"[12] alleged to have been elected in the return, ignores the realities of the situation and begs the basic issue. That issue is whether petitioner, by filing its original return, adopted an adequate method of reflecting income from the sales of subdivision lots and so far reflected income from the installment sales in accordance with the law and the regulations as to permit the Commissioner to refuse, in the interest of an orderly administration of the tax law, to permit the use under a refund claim of the installment sales basis originally available to petitioner.

It is suggested for the respondent[13] that the proper remedy (alleged by respondent now to be barred by limitation) was for petitioner to ask the Commissioner, by a timely claim for refund, to undertake the task of determining the fair market values on the dates of sales of the 257 contracts to purchase, which petitioner held at the end of 1928. Respondent (who is not the Commissioner but the Collector) apparently has failed to consider the magnitude and complexity of the task involved in the foregoing suggestion for, under the facts, such a course plainly would have burdened the Commissioner far more than the installment basis which petitioner seeks to have employed.

The purchaser obligations, in respect of which "fair market values" would have to be determined, were not reflected by promissory notes but were merely the contractual agreements of the purchasers to pay balances due upon purchase prices of lots. Title to these lots remained in the seller who reserved an option to permit cancellation of the obligations, in the event of defaults, upon forfeiture of pay-

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[12] Art. 354, Regs. 74; Appendix, p. 38. The statement in a stipulation (R. 43) that in petitioner's return the "sales were treated as deferred payment sales not on the installment plan and the obligations of the purchaser were treated as having a fair market value equivalent to their fair value", is primarily a legal conclusion, and is contrary to clear and unchallenged testimony of the officer who made the return (R. 108, 111-113) and other testimony (R. 119).

[13] Brief in Opposition, pp. 8-9.

ments previously made (R. 94, 96-98). In many instances contracts of this type have been held to have no market values, or values far less than their face amounts, and controversies as to such values have been numerous. Compare G. C. M. 3350, VII-1 Cumulative Bulletin, p. 62; *Cambria Development Company* v. *Commissioner*, 34 B. T. A. 1155, 1158; *Trust No. 5522, etc., Security-First National Bank, Trustee* v. *Commissioner*, 27 B. T. A. 1250, reversed as to another issue, 83 F. (2d) 801 (C. C. A. 9th); *Biscayne Bay Islands Company* v. *Commissioner*, 23 B. T. A. 731, 735; *Rapid Transit Land Sales Company* v. *Commissioner*, 20 B. T. A. 608; *Ravlin Corporation* v. *Commissioner*, 19 B. T. A. 1112; *Woodmar Realty Co.* v. *Commissioner*, 17 B. T. A. 88, 89; *Calvin T. Graves* v. *Commissioner*, 17 B. T. A. 1318, 1324.

The primary object of the Treasury regulations and of the statutory provisions allowing the use of the installment sales basis for determining income, in cases such as this, from sales with low initial payments, was to "eliminate necessity for appraisals of the obligations of purchaser" (Sen. Rep. No. 52, 69th Cong., 1st Sess., p. 19), and the remedy suggested for this petitioner is in direct conflict with the attainment of that objective.

G. The regulations applicable to closed sales offer no relief to petitioner.

Petitioner's 1928 return (R. 42) and its claim for refund (R. 17, 48, 124) show consistent losses from its other activities and, we submit, preclude any inference that the error made in the 1928 return concerning the subdivision venture could be compensated for in later years by deductions of "losses" resulting from cancellations of the defaulted contracts as contemplated by Regulations 74, Article 354.

In any event, the regulations with regard to closed sales apply to cases where the purchaser obligations have actual and determinable market values, by which income realized in the initial year of each contract can be measured. Where,

as here, there has been no attempt at determination of market values of the obligations and the income was computed on a wholly erroneous view, using a figure grossly in excess of the value of the obligations and so overstating the income in the initial year of the venture, the provisions of Article 354 are entirely inapplicable and would not be apt even if the taxpayer's situation were such that losses sustained in a later year would help it.

While taxing statutes sometimes produce illogical and even unreasonable results, only express language justifies so construing them. *Fleischmann Construction Company* v. *United States*, 270 U. S. 349, 360; *Crooks* v. *Harrelson*, 282 U. S. 55, 60. So in this case, it is not sensible that a taxpayer whose actual situation was as shown by this record should be held to have incurred a 1928 tax liability of as much of $9,669.89. On the basis of realities, its venture was visibly falling, already. Furthermore, it would be in direct conflict with the general policy of the statute, which seeks only to tax income actually received or accrued, to say that, merely because its return was erroneous, petitioner lost the right to have its taxes correctly determined.

II.

Petitioner Was Required to Return Only Its Distributable Share of the Income from Trust No. P. T. 46.[14]

Petitioner, by its amended claim for refund (R. 50-52),[15] advanced the contention that the subdivision trust was a

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[14] Although this proposition was not specifically urged in the petition for certiorari, or in the brief of petitioner, it involves an important error of petitioner, which was urged below (R. 10, 121-123, 174-176, 184-185), and was discussed by respondent in his brief in opposition (p. 10) and is, petitioner believes, properly before this Court.

[15] Compare *United States* v. *Memphis Cotton Oil Co.*, 288 U. S. 62, 71; and *United States* v. *Factors & Finance Co.*, 288 U. S. 89, 94, 96.

separate entity whose income from the real estate venture was not to be charged to petitioner, in the following terms:

> "Claimant now wishes to amend the claim by showing that the subdivision trust is a separate entity, an association taxable as a corporation, that it did not file a consolidated return with claimant in 1928, and that its 1928 income can not be included in claimant's income or return. Accordingly, the income of the subdivision trust must be excluded from claimant's 1928 income, and the tax paid thereon by claimant, refunded. This situation prevents the doctrine of estoppel from applying to this case."

Both courts below in the instant case limited their decisions to the proposition that the trust was a fixed trust in the nature of a mortgage, and being a security device, was not an association taxable as a corporation (R. 29, 199, 206). The Circuit Court of Appeals found that a decision on that point adverse to petitioner was required by the decision of this Court in the case of *A. A. Lewis & Company* v. *Commissioner*, 301 U. S. 385.

Both courts failed to decide whether or not, if the trust was not an association taxable as a corporation (Rev. Act 1928, c. 852, 45 Stat. 791, Sec. 701(a)(2)), it nevertheless was another type of taxable entity—a strict trust—of the kind required by the Revenue Act of 1928 to make tax returns reflecting its operations. Under that statute a trustee of property held in trust is required to make returns showing all income derived by it from dealings in trust property (Sec. 143; Appendix, p. 39) and to pay taxes thereon, except where (as in the case of this trust) the net income from such operations is distributable to beneficiaries (Sec. 161(a)(2) and (a)(4); Appendix, p. 39). In cases where the income is distributable to beneficiaries, the trust is required to make tax returns showing the income distributable to each beneficiary and such beneficiary is required to report such amounts in his tax return (Rev. Act 1928, Sec. 162(b); Treas. Regs. 74, Arts. 861 and 862-(2); Appendix, pp. 39, 40, 41).

On January 3, 1935 (which was after suit was brought in this case), the Successor Trustee of Trust No. P. T. 46 filed with the Commissioner delinquent fiduciary returns (R. 121-123). These returns computed gains from sales of subdivision lots upon the installment plan and reflected income distributable to petitioner in the sum of $4,821.43 for the fractional year 1927 (R. 145, 146), and $15,073.46 for the year 1928 (R. 149, 151).

Petitioner, on appeal to the Circuit Court of Appeals, assigned, among other errors, failure of the District Court to sustain the contention made in the District Court (R. 121-123, 174-176) that Trust No. P. T. 46, Pacific National Bank, Trustee, was the proper entity to report the income from the sales of the subdivision lots (R. 184, 185), and on appeal contended in its brief (pp. 12-13), in part, as follows:

> "The trust involved in this case was a separate entity, whether it is to be deemed a pure trust or an association.
>
> "As the fiduciary of the separate entity, the Trustee had the sole right and the responsibility to keep books, choose its own method of accounting, and file returns upon a method chosen by it. *Sec. 143, Revenue Act of 1928.* Compare *I. T. 2434, C. B. Dec. 1928, p. 106.* See, also, transcript pages 154, 157, inclusive.
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> * * * * * * * * * *
>
> "While the Trustee was delinquent in choosing a method of reporting and in filing its return, it eventually did so and chose the installment method.
>
> "Appellant had but one course to pursue under the law and regulations. It was required to report in its return its distributive share of the trust income as determined and reported to appellant by the Trustee, if the trust was a pure trust, and to report in its return the dividends received if the trust was an association."

If the failure of the lower courts to decide whether petitioner or the trust was the proper entity to report income from sales of the subdivision lots was based upon an unexpressed belief that the amended claim for refund did not

raise that issue, such a conclusion, petitioner submits, was wholly unwarranted.

The amended claim for refund (R. 50-52) definitely stated that the trust was a "separate entity", and that "the income of the subdivision trust must be excluded from claimant's 1928 income". Although these averments were definitely coupled with the further averment that the trust was "an association taxable as a corporation", the Commissioner was sufficiently put on notice of the basic error complained of, i. e., that the Trustee, and not the petitioner, should report the income from the subdivision sales. *Bemis Brothers Bag Company* v. *United States*, 289 U. S. 28; *United States* v. *Factors & Finance Co.*, 288 U. S. 89; *United States* v. *Garbutt Oil Co.*, No. 262 this term, and *United States* v. *Andrews*, No. 48 this term, both decided January 4, 1938.

The Commissioner could not have been misled, since he must have been fully aware that under Section 143 (a) (5) of the Revenue Act of 1928 (Appendix, p. 39) every fiduciary of a strict trust having a gross income of more than $5,000.00 was required to make returns for the trust, and that such requirement extended to trusts described in Sections 161 and 162 of the statute (Appendix, pp. 39-40). Regs. 74, Art. 862-(2), *supra* (Appendix, p. 41). Article 1314 of Regulations 74 provided in that connection as follows:

> "*Association distinguished from trust.*—Where trustees merely hold property for the collection of the income and its distribution among the beneficiaries of the trust, and are not engaged, either by themselves or in connection with the beneficiaries, in the carrying on of any business, and the beneficiaries have no control over the trust, although their consent may be required for the filling of a vacancy among the trustees or for a modification of the terms of the trust, no association exists, and the trust and the beneficiaries thereof will be subject to tax as provided by sections 161-170 and by articles 861-891."

The operation of those regulations is illustrated in the case of *A. A. Lewis & Company* v. *Commissioner*, 301 U. S. 385, 389. The deficiency in that case was asserted against the Trust upon the issue whether the Trust was a strict trust or an association taxable as a corporation. It appears from the record in that case (No. 743, October Term, 1936, at page 7) that the Trustee filed its tax returns on Treasury Form 1041, which is the form prescribed in Article 741 (b) of Treasury Regulations 74[16] for use by a strict trust, the income of which is distributable to beneficiaries. While that fact apparently was not brought to the attention of this Court, its decision that the Trust there involved was not an association taxable as a corporation plainly did not decide or contemplate that the trust entity was to be ignored and that the two beneficiaries there involved were to be taxed as if they had carried on the subdivision venture directly.

In the instant case, Trust No. P. T. 46, Pacific National Bank, Trustee, was created in part for the security of McLeod, the seller of the land to be subdivided (R. 68-84). However, the trust could extend for a period of 20 years (R. 90) and was to be conducted for the sole benefit of petitioner or its assignees after all obligations to McLeod had been discharged (R. 84). Petitioner's primary business was that of a holding company (R. 110-111). It owned a controlling interest in the Bank which was Trustee (R. 44). Petitioner had the privilege of dividing its beneficial interest in the trust and of disposing of certificates of beneficial interest representing fractional beneficial interests in the trust. (R. 85-86). The Trustee was to have a voice in determining the manner in which the properties were to be subdivided (R. 81), and appears actually to have arranged for that work and for the selling of the lots in the first instance (R. 115-117, 141-142). Contracts of sales of the lots were to be executed by the Trustee and retained by it (R. 82). The

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[16] Appendix, p. 40.

purchase prices of the lots, including the installment payments, were to be received by the Trustee, who was to pay therefrom the expenses incurred in connection with the subdividing, improving and selling the properties (R. 82-84). The petitioner's part in the actual business of subdividing and selling the land was largely passive. Although the second contract with a selling agent (R. 54-67) under which most of the lots were sold, was made by petitioner, the entire course of business appears to have passed into the Trustee Bank, which kept its own books and gave the petitioner data on its activities (R. 112, 119). Petitioner in 1928 received no distributions from the Trustee (R. 112), and its only benefits from the trust necessarily consisted of reductions of the purchase money notes.

Petitioner contends that these circumstances bring the trust within the scope of the statute and regulations applicable to strict trusts and that its action in filing a return as if it actually carried on the subdivision operations was erroneous. The facts are quite similar to those involved in *Commissioner* v. *Highlands Evanston-Lincolnwood Subdivision, etc.*, 88 F. (2d) 355, 358 (C. C. A. 7th), certiorari denied 58 S. Ct. 11, in which the trust was held to be an association and the decision of the Board of Tax Appeals (32 B. T. A. 760) that the trust was a mere security device was reversed and remanded. The Board and the Circuit Court of Appeals seem to have recognized that if the trust was not an "association", it plainly was a strict trust and under duty to make its separate tax return as the seller.

In *Crocker* v. *Malley*, 249 U. S. 223, 235, the Collector was allowed to withhold from the refund therein authorized such amount as was due from the trust involved as a strict trust. The trust involved in the instant case is plainly the business type of strict trust referred to by this Court in *Morrissey* v. *Commissioner*, 296 U. S. 344, 359-360.

The activities and responsibilities of the Trustee in this case distinguish it, petitioner contends, from the situations described in G. C. M. 2185, VI-2 Cumulative Bulletin, p. 75,

and G. C. M. 4120, VII-2 Cumulative Bulletin, p. 108, where trust arrangements in connection with the sales of real property were permitted to be disregarded on the theory that in reality the beneficiary alone conducted the transactions. Compare the unpublished ruling of the Deputy Commissioner (R. 154-157) in the case of Trust S-6165, Title Insurance Trust Company, Trustee, in which it is stated at page 156:

> "It is the opinion of this office that inasmuch as trustees are the proper persons to file returns for trusts, and are the only persons required by law to do so, and as it further appears from the trust instrument in this case that the trustee was the only agency authorized to bind the trust, the return filed on March 15, 1928 by the trustee of Trust S-6165, Title Insurance and Trust Company, is to be recognized as the return of the taxpayer in preference to any other returns filed by other persons not properly authorized by the trustee to make returns for the said trust."

Petitioner submits, therefore, that the court below erred in failing to hold that petitioner was entitled to a refund based upon a determination of the amount of trust income from Trust No. P. T. 46, which was distributable to it, such determination to be made upon the installment plan authorized by Section 44(b) of the Revenue Act of 1928, and Treasury Regulations 74, Articles 352-353 (Appendix, pp. 34-35, 36-38). Such a method will result in petitioner's being charged with income to the extent that installment payments were applied in reduction of the purchase money notes (R. 148, 153), and will most clearly reflect the income from the venture.

CONCLUSION.

Petitioner's original return was erroneous and correction of the error was sought by a timely claim for refund. The Circuit Court of Appeals erred in finding that petitioner had lost its right to have its income from the install-

ment sales determined in the manner provided by Section 44 of the Revenue Act of 1928. The decision of the Circuit Court of Appeals should be reversed and the case remanded to the District Court for a determination of petitioner's correct tax liability.

Respectfully submitted,

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MELVIN D. WILSON,
Counsel for Petitioner.

MILLER, CHEVALIER, PEELER & WILSON,
Of Counsel.

February, 1938.

APPENDIX.

Point I.

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. * * *

SEC. 44. INSTALLMENT BASIS.

(a) *Dealers in personal property.*—Under regulations prescribed by the Commissioner with the approval of the Secretary, a person who regularly sells or otherwise disposes of personal property on the installment plan may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the gross profit realized or to be realized when payment is completed, bears to the total contract price.

(b) *Sales of realty and casual sales of personalty.*—In the case (1) of a casual sale or other casual disposition of personal property (other than property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year), for a price exceeding $1,000, or (2) of a sale or other disposition of real property, if in either case the initial payments do not exceed 40 per centum of the selling price, the income may, under regulations prescribed by the Commissioner with the approval of the Secretary, be returned on the basis and in the manner above prescribed in this section. As used in this section the term "initial payments" means the payments received in cash or property other than evidences of

indebtedness of the purchaser during the taxable period in which the sale or other disposition is made.

(c) *Change from accrual to installment basis.*—If a taxpayer entitled to the benefits of subsection (a) elects for any taxable year to report his net income on the installment basis, then in computing his income for the year of change or any subsequent year, amounts actually received during any such year on account of sales or other dispositions of property made in any prior year shall not be excluded.

(d) *Gain or loss upon disposition of installment obligations.*—If an installment obligation is satisfied at other than its face value or distributed, transmitted, sold, or otherwise disposed of, gain or loss shall result to the extent of the difference between the basis of the obligation and (1) in the case of satisfaction at other than face value or a sale or exchange—the amount realized, or (2) in case of a distribution, transmission, or disposition otherwise than by sale or exchange—the fair market value of the obligation at the time of such distribution, transmission, or disposition. The basis of the obligation shall be the excess of the face value of the obligation over an amount equal to the income which would be returnable were the obligation satisfied in full.

SEC. 322. REFUNDS AND CREDITS.

(a) *Authorization.*—Where there has been an overpayment of any tax imposed by this title, the amount of such overpayment shall be credited against any income, war-profits, or excess-profits tax or installment thereof then due from the taxpayer, and any balance shall be refunded immediately to the taxpayer.

(b) *Limitation on allowance.*—

(1) *Period of limitation.*—No such credit or refund shall be allowed or made after two years from the time the tax was paid, unless before the expiration of such period a claim therefor is filed by the taxpayer.

(2) *Limit on amount of credit or refund.*—The amount of the credit or refund shall not exceed the portion of the tax paid during the two years immediately preceding the filing of the claim, or if no claim was filed, then during the two years immediately preceding the allowance of the credit or refund.

* * * * * * * * * *

Revenue Act of 1926, c. 27, 44 Stat. 9:

SEC. 1111 (as amended by Section 619, Revenue Act of 1928, c. 852, 45 Stat. 791). Section 3220 of the Revised Statutes, as amended, is amended to read as follows:

"SEC. 3220. Except as otherwise provided by law in the case of income, war-profits, excess-profits, estate, and gift taxes the Commissioner of Internal Revenue, subject to regulations prescribed by the Secretary of the Treasury, is authorized to remit, refund, and pay back all taxes erroneously or illegally assessed or collected, all penalties collected without authority, and all taxes that appear to be unjustly assessed or excessive in amount, or in any manner wrongfully collected; also to repay to any collector or deputy collector the full amount of such sums of money as may be recovered against him in any court, for any internal-revenue taxes collected by him, with the cost and expenses of suit; also all damages and costs recovered against any assessor, assistant assessor, collector, deputy collector, agent, or inspector, in any suit brought against him by reason of anything done in the due performance of his official duty, and shall make report to Congress at the beginning of each regular session of Congress of all transactions under this section."

Treasury Regulations 74, Revenue Act of 1928:

ART. 352. *Sale of real property involving deferred payments.*—Under section 44 deferred-payment sales of real property fall into two classes when considered with respect to the terms of sale, as follows:

(1) Sales of property on the installment plan, that is, sales in which the payments received in cash or

property other than evidences of indebtedness of the purchaser during the taxable year in which the sale is made do not exceed 40 per cent of the selling price.

(2) Deferred-payment sales not on the installment plan, that is, sales in which the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable year in which the sale is made exceed 40 per cent of the selling price.

Sales falling within class (1) and class (2) alike include (*a*) agreements of purchase and sale which contemplate that a conveyance is not to be made at the outset, but only after all or a substantial portion of the selling price has been paid, and (*b*) sales where there is an immediate transfer of title, the vendor being protected by a mortgage or other lien as to deferred payments.

* * * Commissions and other selling expenses paid or incurred by the vendor are not to be deducted or taken into account in determining the amount of the "initial payments," the "total contract price," or the "selling price."

ART. 353. *Sale of real property on installment plan.*—In transactions included in class (1) in article 352 the vendor may return as income from such transactions in any taxable year that proportion of the installment payments actually received in that year which the total profit realized or to be realized when the property is paid for bears to the total contract price.

*If the vendor had retained title to the property and the purchaser defaults in any of his payments, and the vendor repossesses the property by agreement or process of law, the difference between (1) the entire amount of the payments actually received on the contract and retained by the vendor and (2) the sum of the profits previously returned as income in connection therewith and an amount representing what would have been a proper adjustment for exhaustion, wear and tear, obsolescence, amortization, and depletion of the property during the period the property was in the hands of the

*Amended by T. D. 4360, XII-1 C. B. 116.

purchaser had the sale not been made, will constitute gain or loss, as the case may be, to the vendor for the year in which the property is repossessed, and the basis of the property in the hands of the vendor will be the original basis at the time of the sale. * * *

If the vendor chooses as a matter of consistent practice to return the income from installment sales on the straight accrual or cash receipts and disbursements basis, such a course is permissible, and the sales will be treated as deferred-payment sales not on the installment plan.

ART. 354. *Deferred-payment sale of real property not on installment plan.*—In transactions included in class (2) in article 352, the obligations of the purchaser received by the vendor are to be considered as the equivalent of cash to the amount of their fair market value in ascertaining the profit or loss from the transaction.

If the vendor had retained title to the property and the purchaser defaults in any of his payments, and the vendor repossesses the property by agreement or process of law, the difference between (1) the entire amount of the payments actually received on the contract and retained by the vendor and (2) the sum of the profits previously returned as income in connection therewith and an amount representing proper adjustment for exhaustion, wear and tear, obsolescence, amortization, and depletion of the property while in the hands of the purchaser, will constitute gain or loss, as the case may be, to the vendor for the year in which the property is repossessed, and the basis of the property in the hands of the vendor will be the original basis at the time of the sale. * * *

If the obligations received by the vendor have no fair market value, the payments in cash or other property having a fair market value shall be applied against and reduce the basis of the property sold, and, if in excess of such basis, shall be taxable to the extent of the excess. Gain or loss is realized when the obligations are disposed of or satisfied, the amount being the difference between the reduced basis as provided above and the amount realized therefor. Only in rare and extraordinary cases does property have no fair market value.

Point II.

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 143. FIDUCIARY RETURNS.

(a) *Requirement of return.*—Every fiduciary (except a receiver appointed by authority of law in possession of part only of the property of an individual) shall make under oath a return for any of the following individuals, estates, or trusts for which he acts, stating specifically the items of gross income thereof and the deductions and credits allowed under this title—

* * * * * * * * *

(5) Every estate or trust the gross income of which for the taxable year is $5,000 or over, regardless of the amount of the net income;

* * * * * * * * *

SEC. 161. IMPOSITION OF TAX.

(a) *Application of tax.*—The taxes imposed by this title upon individuals shall apply to the income of estates or of any kind of property held in trust, including—

* * * * * * * * *

(2) Income which is to be distributed currently by the fiduciary to the beneficiaries, and income collected by a guardian of an infant which is to be held or distributed as the court may direct;

* * * * * * * * *

(4) Income which, in the discretion of the fiduciary, may be either distributed to the beneficiaries or accumulated.

* * * * * * * * *

SEC. 162. NET INCOME.

The net income of the estate or trust shall be computed in the same manner and on the same basis as in the case of an individual, except that—

* * * * * * * * *

(b) There shall be allowed as an additional deduction in computing the net income of the estate or trust, the amount of the income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to the beneficiaries, and the amount of the income collected by a guardian of an infant which is to be held or distributed as the court may direct, but the amount so allowed as a deduction shall be included in computing the net income of the beneficiaries whether distributed to them or not. * * * .

Treasury Regulations 74, Revenue Act of 1928:

ART. 741. *Fiduciary returns.*—Every fiduciary, or at least one of joint fiduciaries, must make a return of income—

* * * * * * *

(b) For the estate or trust for which he acts if the net income of such estate or trust is $1,500 or over, or if the gross income of the estate or trust is $5,000 or over, regardless of the amount of the net income, or if any beneficiary of such estate or trust is a nonresident alien.

The return in case (*a*) shall be on Form 1040 or 1040 A. In case (*b*) a return is required on Form 1040 with respect to any taxable net income of the estate or trust computed in accordance with section 162 and a return on Form 1041 with respect to any income deducted under section 162 (b) or (c). If a portion of the income of the estate or trust is retained by the fiduciary and the remainder its distributable or distributed to beneficiaries, both Forms 1040 and 1041 will be required. (See article 862.) * * *

ART. 861. *Estates and trusts.*—In general, the income of a trust for the taxable year which is to be distributed to the beneficiaries must be returned by and will be taxed to the respective beneficiaries, but the income of a trust which is to be accumulated or held for future distribution, whether consisting of ordinary income or gain from the sale of assets included in the corpus of the trust, must be returned by and will be taxed to the trustee. * * *

See section 143 and articles 741-746 with reference to fiduciary returns, and section 24 and articles 281-284 with reference to items not deductible. (See also article 154.)

ART. 862. *Method of computation of net income and tax.* * * *

(2) The amount of the income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to the beneficiaries, and the amount of the income collected by a guardian of an infant which is to be held or distributed as the court may direct, shall be allowed as an additional deduction in computing the net income of the estate or trust. The amount so allowed as a deduction must be included by the beneficiaries in computing their net income, whether distributed to them or not. * * *

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In the Supreme Court of the United States

OCTOBER TERM, 1937

No. 528

PACIFIC NATIONAL COMPANY, A CORPORATION, PETITIONER

v.

GALEN H. WELCH, FORMER COLLECTOR OF INTERNAL REVENUE FOR THE SIXTH DISTRICT OF CALIFORNIA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The District Court did not render a written opinion. The opinion of the Circuit Court of Appeals (R. 198) is reported at 91 F. (2d) 590.

JURISDICTION

The judgment of the court below was entered on August 2, 1937 (R. 207). The petition for a writ of certiorari was filed on October 25, 1937. The jurisdiction of this Court is invoked under Section

240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Where a taxpayer filed its return for 1928 in accordance with the method used in its books, reporting sales of certain real estate as completed transactions with all of the consideration as received in that year, may it, upon filing a claim for refund in 1931, change the method and have the profits from the sales computed on the installment basis?

STATUTE AND REGULATIONS INVOLVED

The pertinent portions of the applicable statute and regulations are set forth in the Appendix, *infra*, pp. 15–19.

STATEMENT

The facts as stipulated and as found by the District Court (R. 23–28), so far as material, may be summarized as follows:

The petitioner is a corporation organized under the laws of the State of California, and has its principal office and place of business in Los Angeles, California. The respondent was from April 6, 1926, to June 30, 1933, the duly commissioned and acting Collector of Internal Revenue for the Sixth Collection District of California, and has his office in Los Angeles, California. (R. 23–24.)

The petitioner filed its corporation income tax return for the calendar year 1928 with the re-

spondent on March 14, 1929, in accordance with the basis upon which its books were kept, and paid to the respondent in four installments during 1929 the tax of $10,761.28 shown on the return (R. 24).

In 1927 the petitioner purchased the legal title to certain property. This property was conveyed to the Pacific National Bank in trust as trustee for Trust No. P. T. 46. The petitioner became the sole beneficiary of this trust, and continued so during the entire calendar year 1928. (R. 24, 44.)

In October, 1927, the petitioner employed Frank J. Brick to conduct a sales campaign of subdivision lots included in the holdings of Trust No. P. T. 46, and, with the knowledge, consent, acquiescence and approval of the petitioner, Brick successfully conducted a "high pressure" sales campaign. The petitioner obtained and retained financial benefit and income from the sales made by Brick. (R. 2.)

In its return for 1928 the petitioner reported income from Trust No. P. T. 46 in the amount of $137,007.17, resulting from the sale of subdivision lots. In the determination of this income the sales of the lots were treated as deferred payment sales not on the installment plan, and the obligations of the purchasers were treated as having a fair market value equivalent to their face value. (R. 25.)

The books and records of the trust were kept on the cash receipts and disbursements basis. The

trustee, Pacific National Bank, did not file a fiduciary or other income tax return for the trust for the years 1927 or 1928, nor did its successor trustee do so prior to the institution of the present action. (R. 25–26.)

On February 26, 1931, the petitioner filed a claim for refund of the taxes paid for 1928, setting forth as one of the grounds for the claim that "Profit from sales of real estate in a subdivision trust were erroneously reported as based on closed sales, although the sales were made on the installment basis and proceeds of sales and collections were allocated by the Trustee" (R. 26).

On May 17, 1932, the Commissioner allowed the claim for refund in part upon grounds not in issue here, but rejected that portion of it based upon the ground quoted above (R. 27).

No claim for refund was filed by the petitioner which presented the contention, sought to be raised at the trial, that the obligations of the purchasers of lots from Trust No. P. T. 46 had a fair market value less than the equivalent of their face value (R. 28).

Upon the findings of fact the District Court concluded as a matter of law that the petitioner by its action in filing an income tax return for the calendar year 1928, in which it reported the proceeds from the sale of lots from the subdivision trust upon the deferred payment plan rather than the installment plan, made an election as to the method of reporting the sales, which election be-

came final and binding upon the expiration of the time for filing income tax returns for the calendar year 1928 (R. 30). The judgment in favor of the respondent (R. 32–33) was affirmed by the Circuit Court of Appeals (R. 207).

ARGUMENT

Section 44 (b) of the Revenue Act of 1928, *infra*, p. 15, provides that in the case of a sale or other disposition of real estate, if the initial payments do not exceed 40 per centum of the selling price, the income may, under regulations prescribed by the Commissioner with the approval of the Secretary, be returned on the installment basis; that is, the taxpayer may return as income in any taxable year that proportion of the installment payments actually received in that year which the gross profit realized or to be realized when payment is completed bears to the total contract price.

This provision of the Revenue Act of 1928 is substantially the same as the provision in Section 212 (d) of the Revenue Act of 1926, except that under the 1926 Act a taxpayer was not permitted to use the installment basis if the initial payments exceeded one-fourth of the purchase price. Prior to the Act of 1926 there had been no express statutory provision for the use of the installment plan, the earlier Revenue Acts definitely recognizing only two bases for tax returns—cash and accrual. "The new plan was optional; taxpayers were allowed to elect whether to make returns under the regulations upon the new basis or upon one of the old

bases." *Burnet* v. *S. & L. Bldg. Corp.*, 288 U. S. 406, 413.

1. The present case arises under the Revenue Act of 1928. The petitioner prepared its 1928 income tax return from its books of account upon the basis upon which those books were kept, and reported the sum of $137,007.17 as income resulting from the sale of subdivision lots, in the determination of which the sales were treated as deferred payment sales not on the installment plan, and the obligations of the purchaser were treated as having a fair market value equivalent to their face value. Approximately two years later the petitioner filed a claim for refund in which it sought to change the basis of reporting the sales to the installment plan, and, upon the rejection of the claim, brought the present suit.

As held by this Court in *Burnet* v. *S. & L. Bldg. Corp., supra,* the installment plan of reporting sales is optional and a taxpayer may make an election between that plan and the cash or the accrual basis. Where a taxpayer has the right to elect between two different methods of reporting income, the overwhelming weight of authority is to the effect that when a taxpayer has once made his return in accordance with one of these methods he may not, in the absence of exceptional or unusual circumstances, subsequently change to the other method. *Radiant Glass Co.* v. *Burnet,* 54 F. (2d) 718 (App. D. C.); *Dr. Pepper Bottling Co.* v. *Commissioner,* 69 F. (2d) 768 (C. C. A. 5th);

Lucas v. *St. Louis National Baseball Club,* 42 F. (2d) 984 (C. C. A. 8th), certiorari denied, 282 U. S. 883; *Safety Electric Products Co.* v. *Helvering,* 70 F. (2d) 439 (C. C. A. 9th). The foregoing cases involved the option of affiliated corporations to file consolidated returns or separate returns. The following cases involved the filing of joint or separate returns by husband and wife: *Morris* v. *Commissioner,* 40 F. (2d) 504 (C. C. A. 2d); *Rose* v. *Grant,* 39 F. (2d) 340 (C. C. A. 5th); *Anderson* v. *United States,* 48 F. (2d) 201 (C. C. A. 5th); *Buttolph* v. *Commissioner,* 29 F. (2d) 695 (C. C. A. 7th); *United States* v. *Pettigrew,* 81 F. (2d) 666 (C. C. A. 9th). The uniform ruling is that the same principle applies as to the election to report on the closed transaction or the installment basis. *Strauss* v. *Commissioner,* 33 B. T. A. 855, affirmed *per curiam,* 87 F. (2d) 1018 (C. C. A. 2d); *Rundel* v. *Commissioner,* 21 B. T. A. 1019; *Johnson Realty Trust* v. *Commissioner,* 21 B. T. A. 1333; *Ellis* v. *Commissioner,* 16 B. T. A. 1225; *Viault* v. *Commissioner,* 36 B. T. A. 430. See also *Moran* v. *Commissioner,* 67 F. (2d) 601 (C. C. A. 1st).

The petitioner in the present case apparently admits that this is the general rule. At pages 20–21 of the brief in support of its petition it states:

> It is proper to hold a taxpayer to his original choice between two correct methods, when subsequent events show that he did not choose the more favorable one. It is quite another matter to hold a taxpayer to a

method which was wrong from the very beginning.

It may be, as the petitioner contends, that the courts should not and will not hold a taxpayer bound to the use of a method of reporting income which the courts regard as having been wrong from the beginning and which inherently, that is, aside from some error committed by the taxpayer in the use of the method, does not correctly reflect income. To bring itself within such an exception to the general rule, a taxpayer should, however, make a clear case, particularly where, as here, the Commissioner has accepted the method originally chosen by the taxpayer as one which does correctly reflect the taxpayer's income. The contentions of the petitioner that the basis upon which it originally reported the sales did not correctly reflect its income are not rested upon any of the findings of fact made by the District Court or upon the facts which were stipulated.

Furthermore, the District Court has found as a fact that the petitioner's 1928 income-tax return was prepared upon the same basis upon which the petitioner's books of account were kept, and concluded as a matter of law that the returns met the requirements of the Revenue Act and the Regulations of the Treasury Department (R. 24, 29).

The petitioner argues (Br. 9) that at the end of the taxable year 40 per cent of the contracts were delinquent, and states (Br. 17) that it never actually received a cent from the trust venture and that

it was readily discernible at the end of 1928 that it would not get any income out of the trust. Even if these facts had been established by the proofs, we submit they would not show that the petitioner had used a method of reporting income which would not correctly reflect its income. Perhaps the petitioner placed too high a fair market value upon the obligations of the purchasers received upon the sales, as testified by one of its witnesses (R. 117–118), and therefore has paid a tax which it would not otherwise have had to pay for 1928. Its failure to secure relief on this ground was denied solely because it had not filed a timely claim for refund asserting that contention (R. 28, 29). But at the most that was merely an error which it made in the method used by it, and it is not shown that the method itself was wrong. As to the contracts which were delinquent at the end of 1928, there is an absence in the record of any evidence to establish that at the time there was ground for believing that the delinquencies would not be cured in subsequent years. In any event, however, the fact is immaterial under the closed transaction basis used by the petitioner in its return. The Revenue Acts, furthermore, provide for compensating adjustments and deductions when the contracts are realized upon or when the property sold is retaken by the vendor. See Treasury Regulations 74, Article 354, *infra*, pp. 17–19.

If, as the petitioner says, it received nothing from the trust during 1928, that fact also does not show there was no profit from the sales of the real estate or that such profit was improperly computed. As stated by the court below (R. 199–200), the trust indenture was a security device. It was also a selling and disbursing agency for the petitioner. Under it, the petitioner obligated itself, among other things (R. 74–75), to pay all claims, taxes, liens, assessments, charges and encumbrances affecting title to any part of the property, all costs, charges and expenses of the trust, all costs and expenses of the subdivision, and the principal and interest upon the notes of the petitioner secured by the trust. The trustee was to execute contracts of sale or deeds to purchasers upon the sole written instructions of the petitioner (R. 82), and the entire sales price of each lot was to be paid to the trustee (R. 82) and by it disbursed to discharge the obligations of the petitioner (R. 83–84). There was here the common relation of principal and agent, coupled with the collateral incidents of an ordinary trust. Cf. *Lewis & Co.* v. *Commissioner,* 301 U. S. 385.

We submit that the petitioner has failed to show that the basis upon which it originally reported the sales was one which would not correctly reflect its income, and that the petitioner may not, therefore, urge that it should not be bound by the method which it used on the ground that it was wrong from the very beginning.

2. The petitioner contends (Br. 21) that there can be no election without knowledge of the inconsistent remedies.

It appears from the petitioner's own statement (Br. 19) that its secretary, who made the return for the petitioner, was familiar generally with the installment method of reporting sales of property. The petitioner's contention is that its secretary was guided by the Regulations under the Revenue Act of 1926, which permitted the use of the installment basis only where the initial payments did not exceed 25 per cent of the selling price, and was not aware that the Revenue Act of 1928 had changed the provision to permit the use of the installment basis where the initial payments did not exceed 40 per cent. There is no suggestion by the petitioner that it was not fully advised as to the facts surrounding the sales. When the petitioner prepared its 1928 return, the Revenue Act of 1928 had been in force for more than nine months, and if the petitioner's secretary failed to inform himself of the provisions of that Act, his ignorance should not excuse the petitioner. *Buttolph* v. *Commissioner,* 29 F. (2d) 695, 696 (C. C. A. 7th).

3. The petitioner has cited conflict between the present decision and various decisions of the Circuit Courts of Appeals, the Court of Claims, and the Board of Tax Appeals. We have cited other decisions from those same courts which serve to distinguish the decisions principally relied on by the petitioner and which make it clear that the general

rule is as we contend here and that only in unusual circumstances will this general rule not be applied.

In *Morrow, Becker & Ewing, Inc.* v. *Commissioner,* 57 F. (2d) 1 (C. C. A. 5th), upon which the petitioner relies, the income tax return of the taxpayer, who was engaged in selling real estate on an installment plan, was made a few days after the enactment of the Revenue Act of 1926, which substantially changed the preexisting law, and before the adoption of the Treasury Regulations for carrying out the provisions of the statute as to the basis for determining profits and losses on installment sales of real estate. The court decided that an amendment of the return to make it conform with the Regulations adopted after the return was made was permissible. The court in its opinion in that case stated (pp. 2–3) that the case was not one where, the law being well settled, the taxpayer had elected to keep his books on a certain basis and to make returns accordingly and had afterwards attempted to change the method of accounting or the basis of the return. The court pointed out that if it were such a case it would be proper to hold the taxpayer estopped, as an orderly administration of the revenue laws would otherwise be impossible. Cf. the decision of the same court in *Dr. Pepper Bottling Co.* v. *Commissioner,* 69 F. (2d) 768.

In *Kaplan* v. *United States,* 18 F. Supp. 965, the Court of Claims held, though upon insufficient findings of fact, that the taxpayer, who was upon

a cash receipts basis, had erroneously and mistakenly reported in his return for the taxable year the entire profit which it appeared at the time might ultimately be received but which was not actually received, and that the basis on which he reported the transaction did not clearly reflect his income. While we do not believe that that decision is correct we think it is distinguishable from the present case when read in the light of the opinion of the Court of Claims in *LeBolt & Co.* v. *United States*, 67 C. Cls. 422, where the court said (p. 426):

> The weight of authority is to the effect that where there are two methods of making an income-tax return, either one of which is legal and proper, and the taxpayer has made his return in accordance with one of these methods, then, if the return is accepted and taxes paid accordingly, the taxpayer can not subsequently change to the other method of making a return and thereby become entitled to a refund. But if there is only one legal and proper method of making a return and the taxpayer erroneously makes his return by some other method, then, even, though the return has been accepted and the taxes paid, he may file an amended return correcting the error, and if this return shows an overpayment, he becomes entitled to a refund.

The facts in the present case are different from the facts in the cases relied upon by the petitioner. Here there were no misleading regulations, and

no other unusual circumstances. The law was clear and the petitioner had ample time to inform itself as to its provisions. The return as originally made used a basis which would correctly reflect the petitioner's income. We submit, therefore, that there is no conflict of decisions justifying the issuance of a writ of certiorari in the present case.

CONCLUSION

The decision of the court below is correct. There is no conflict of decisions. The petition for a writ of certiorari should be denied.

Respectfully submitted.

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NOVEMBER, 1937.

APPENDIX

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 44. INSTALLMENT BASIS.

(a) *Dealers in personal property.*—Under regulations prescribed by the Commissioner with the approval of the Secretary, a person who regularly sells or otherwise disposes of personal property on the installment plan may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the gross profit realized or to be realized when payment is completed, bears to the total contract price.

(b) *Sales of realty and casual sales of personalty.*—In the case (1) of a casual sale or other casual disposition of personal property (other than property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year), for a price exceeding $1,000, or (2) of a sale or other disposition of real property, if in either case the initial payments do not exceed 40 per centum of the selling price, the income may, under regulations prescribed by the Commissioner with the approval of the Secretary, be returned on the basis and in the manner above prescribed in this section. As used in this section the term "initial payments" means the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable period in which the sale or other disposition is made.

* * * * *

Treasury Regulations 74:

ART. 352. *Sale of real property involving deferred payments.*—Under section 44 deferred-payment sales of real property fall into two classes when considered with respect to the terms of sale, as follows:

(1) Sales of property on the installment plan, that is, sales in which the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable year in which the sale is made do not exceed 40 per cent of the selling price.

(2) Deferred-payment sales not on the installment plan, that is, sales in which the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable year in which the sale is made exceed 40 per cent of the selling price.

Sales falling within class (1) and class (2) alike include (a) agreements of purchase and sale which contemplate that a conveyance is not to be made at the outset, but only after all or a substantial portion of the selling price has been paid, and (b) sales where there is an immediate transfer of title, the vendor being protected by a mortgage or other lien as to deferred payments.

* * * * *

ART. 353. *Sale of real property on installment plan.*—In transactions included in class (1) in article 352 the vendor may return as income from such transactions in any taxable year that proportion of the installment payments actually received in that year which the total profit realized or to be realized when the property is paid for bears to the total contract price.

If for any reason the purchaser defaults in any of his payments, and the vendor re-

turning income on the installment basis repossesses the property, the entire amount received in installment payments and retained by the vendor, less the sum of the profits previously returned as income and an amount representing proper adjustment for exhaustion, wear and tear, obsolescence, amortization, and depletion of the property while in the hands of the purchaser, will be income of the vendor for the year in which the property is repossessed, and the basis of the property in the hands of the vendor will be the original basis at the time of the installment sale.

If the vendor chooses as a matter of consistent practice to return the income from installment sales on the straight accrual or cash receipts and disbursements basis, such a course is permissible, and the sales will be treated as deferred-payment sales not on the installment plan.

ART. 354. *Deferred-payment sale of real property not on the installment plan.*—In transactions included in class (2) in article 352, the obligations of the purchaser received by the vendor are to be considered as the equivalent of cash to the amount of their fair market value in ascertaining the profit or loss from the transaction.

If the vendor had retained title to the property and the purchaser defaults in any of his payments, and the vendor repossesses the property by agreement or process of law, the difference between (1) the entire amount of the payments actually received on the contract and retained by the vendor and (2) the sum of the profits previously returned as income in connection therewith and an amount representing proper adjustment for exhaustion, wear and tear, obsolescence.

amortization, and depletion of the property while in the hands of the purchaser, will constitute gain or loss, as the case may be, to the vendor for the year in which the property is repossessed, and the basis of the property in the hands of the vendor will be the original basis at the time of the sale. If the vendor had previously transferred title to the purchaser, and the purchaser defaults in any of his payments and the vendor reacquires the property, such repossession shall be regarded as a transfer by the vendor, in exchange for the property, of such of the purchaser's obligations as are applied by the vendor to the purchase or bid price of the property. Such an exchange will be regarded as having resulted in the realization by the vendor of gain or loss, as the case may be, for the year of repossession, measured by the difference between the fair market value of the property and the basis in the hands of the vendor of the obligations of the purchaser (generally, the fair market value thereof which was previously recognized in computing income) which were applied by the vendor to the purchase or bid price of the property. The fair market value of the property shall be presumed to be the amount for which it is bid in by the vendor in the absence of clear and convincing proof to the contrary. If the property so acquired is subsequently sold, the basis for determining gain or loss is the fair market value of the property at the date of acquisition.

If the obligations received by the vendor have no fair market value, the payments in cash or other property having a fair market value shall be applied against and reduce the basis of the property sold, and, if in excess of such basis, shall be taxable to

the extent of the excess. Gain or loss is realized when the obligations are disposed of or satisfied, the amount being the difference between the reduced basis as provided above and the amount realized therefor. Only in rare and extraordinary cases does property have no fair market value.

ART. 355. Gain or loss upon disposition of installment obligations.—If an installment obligation is satisfied at other than its face value or is sold or exchanged, gain or loss results to the extent of the difference between (1) the excess of the face value of the obligation over the amount of income which would be returnable were the obligation satisfied in full and (2) the amount realized upon such disposition.

If an installment obligation is distributed, transmitted, or disposed of otherwise than by sale or exchange, gain or loss results to the extent of the difference between (1) the excess of the face value of the obligation over the amount of income which would be returnable were the obligation satisfied in full and (2) the fair market value of the obligation at the time of such distribution, transmission, or disposition.

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In the Supreme Court of the United States

OCTOBER TERM, 1937

No. 528

PACIFIC NATIONAL COMPANY, A CORPORATION
PETITIONER

v.

GALEN H. WELCH, FORMER COLLECTOR OF INTERNAL REVENUE, FOR THE SIXTH DISTRICT OF CALIFORNIA

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT

OPINION BELOW

The District Court did not render a written opinion. The opinion of the Circuit Court of Appeals (R. 198–207) is reported at 91 F. (2d) 590.

JURISDICTION

The judgment of the court below was entered on August 2, 1937 (R. 207). The petition for certiorari was filed on October 25, 1937, and was

granted on December 6, 1937. The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The only question presented by the petition for certiorari is whether the petitioner, which in 1929 reported its income for 1928 from the sale of real estate as deferred payment sales not on the installment plan, is bound by that election or can later, in 1931, claim a refund of taxes by having its gain from the sales of realty taxed on the installment basis.

Although not raised in its petition, the petitioner also asks this Court to decide the further question whether the petitioner is taxable upon only its alleged distributable share of the income of the subdivision trust involved.

STATUTES AND REGULATIONS INVOLVED

The pertinent portions of the applicable statutes and treasury regulations are printed in the Appendix, *infra*, pp. 42–51.

STATEMENT

This action was brought by Pacific National Company, the petitioner, in the United States District Court for the Southern District of California to recover from the respondent, a former Collector of Internal Revenue for the Sixth Collection District of California, the sum of $9,669.89, with in-

terest, paid by the petitioner as Federal income taxes due for the year 1928 (R. 4–11). A jury was waived (R. 37–38), and the cause tried to the court upon a stipulation of facts (R. 39–105) and oral and documentary evidence (R. 106–157). The District Court did not render an opinion but made special findings of fact and conclusions of law (R. 23–31) and entered judgment for the respondent (R. 32–33). The petitioner appealed to the Circuit Court of Appeals for the Ninth Circuit (R. 182) assigning numerous errors (R. 183–188). That court rendered an opinion and affirmed the decision of the District Court (R. 198–207).

The facts stipulated and found by the trial court, so far as material here, may be summarized as follows:

The petitioner is a corporation organized under the laws of the State of California, having its principal office and place of business at Los Angeles, California (R. 23, 40).

In 1927 the petitioner purchased the legal title to certain real property, known as the Culver City Tract, for a consideration of $609,000, of which $309,000 was paid in cash and $300,000 was represented by purchase money notes (R. 44, 115). This property was conveyed to the Pacific National Bank, as trustee, under a trust agreement designated as Trust No. P. T. 46 (R. 24, 44, 68–92). The petitioner became sole beneficiary under this so-called "subdivision trust" and remained so during the year 1928 (R. 24, 44, 114).

In October 1927 the petitioner employed one Frank J. Brick as exclusive selling agent to conduct a sales campaign to sell lots from the property transferred under the trust agreement designated No. P. T. 46. With the knowledge, consent, acquiescence, and approval of the petitioner, Brick successfully conducted a high pressure sales campaign (R. 28, 44, 54–61). The petitioner obtained and retained financial benefit from the sales made by Brick (R. 28).

The petitioner prepared its 1928 income tax return from its books of account and upon the same basis upon which those books were kept (R. 24).

The petitioner filed its income tax return (R. 128–139) for the year 1928 on March 14, 1929, disclosing net income of $89,677.34 and a tax due thereon in the sum of $10,761.28, which was paid to the respondent in quarterly installments during 1929 (R. 24–25, 41). The income of $89,677.34 shown on the petitioner's 1928 return was made up as follows (R. 25, 42, 128–130):

Income from Trust No. P. T. 46, Pacific National Bank, Trustee	$137,007.17
Less:	
Loss of Plaintiff from its 1928 operations, exclusive of the trust income	11,480.37
Statutory net losses of plaintiff, as follows:	
1925	1,990.77
1926	9,708.66
1927	24,150.03
	47,329.83
Net income as reported	89,677.34

The sum of $137,017.17 representing the income from Trust No. P. T. 46 resulted from the sale of subdivision lots. In determining that income the sales were treated as deferred payment sales not on the installment plan and the obligations of the purchasers were treated as having a fair market value equivalent to their face value (R. 25, 43).

The Pacific National Bank, as trustee under Trust No. P. T. 46, kept the books and records of the trust upon the basis of cash receipts and disbursements.[1] This trustee did not file a fiduciary or other income tax return for the trust for the years 1927 or 1928, nor did the successor trustee do so prior to the institution of this action (R. 25–26, 43).

On February 26, 1931, the petitioner filed with the Collector of Internal Revenue at Los Angeles, California, a claim for refund of the full amount of income taxes paid for 1928. The only ground for refund stated in that claim which is material to this proceeding was that (R. 26, 41, 46–48):

> (3) Profit from sales of real estate in a subdivision trust were erroneously reported as based on closed sales, although the sales were made on the installment basis and pro-

[1] It was not expressly found or stipulated but it appears that the petitioner kept its books on a cash receipts and disbursements basis in which the purchasers' contracts were treated as the equivalent of cash received in the amount of their face value. The income was reported in accordance with this method of keeping the books (R. 108–114).

ceeds of sales and collections were allocated by the trustee.

On April 4, 1932, the petitioner filed another claim for refund of the full amount of income taxes paid for 1928, stating as grounds for its claim that (R. 28, 41, 50–52):

> Claimant now wishes to amend the claim by showing that the subdivision trust is a separate entity, an association taxable as a corporation, that it did not file a consolidated return with claimant in 1928, and that its 1928 income can not be included in claimant's income or return. Accordingly, the income of the subdivision trust must be excluded from claimant's 1928 income, and the tax paid thereon by claimant, refunded. This situation prevents the doctrine of estoppel from applying to this case.

On May 17, 1932, the Commissioner of Internal Revenue allowed the petitioner's claim for refund filed February 26, 1931, to the extent of $1,091.39, upon grounds not in issue in this proceeding, and rejected it as to the balance. On July 25, 1932, the Commissioner confirmed the rejection of May 17, 1932, and in his ruling of July 25, 1932, he considered all of the claims theretofore filed by the petitioner (R. 27–28, 42).

Petitioner filed no claims for refund of the tax involved in this proceeding other than those filed February 26, 1931, and April 4, 1932 (R. 28).

The issue that Trust No. P. T. 46, Pacific National Bank, Trustee, was an association taxable

as a corporation and not as a trust was not presented to the Commissioner of Internal Revenue in any claim for refund filed prior to April 4, 1932, and this claim for refund was not filed within two years from the date of payment of any portion of the tax reported for the calendar year 1928 (R. 28).

In the stipulation of facts filed with the District Court it was agreed that upon a decision of the legal questions involved the determination of the correct amount of tax under the decision would be referred back to the parties for settlement (R. 44–45). During the progress of the trial it was further stipulated that should the court decide either that the petitioner is entitled to change its method of computing income or that the trust should have reported the income on the basis of an association taxable as a corporation there would be some refund due. It was further agreed that should a change of basis be granted no income would escape taxation in subsequent years by reason of the statute of limitations (R. 118).

SUMMARY OF ARGUMENT

I

The petitioner elected to report its income on the deferred payment method and not on the installment basis. The method adopted is authorized by the Revenue Act of 1928 and the treasury regulations, was used in the petitioner's books and income tax return, and clearly reflected the petitioner's income.

Such an election is binding and prevents the petitioner from changing to the installment basis in a claim for refund in order to have a lesser income and a refund determined. Any general rule permitting such changes would hinder administration of the revenues.

II

The contention, now raised for the first time and not presented in the petition for certiorari, that the income is taxable as the income of a trust, cannot be considered in this action because it was not presented in a timely refund claim and was not presented in this action below. Moreover, the contention is without merit because this trust, a mere security device, is not taxable as a trust.

ARGUMENT

I

THE PETITIONER ELECTED TO REPORT ITS INCOME ON THE DEFERRED PAYMENT BASIS IN ACCORDANCE WITH THE METHOD OF ACCOUNTING USED IN ITS BOOKS AND THEREFORE CANNOT CHANGE TO THE INSTALLMENT BASIS

The petitioner contends in Point I of its brief (pp. 7–26) that the installment basis alone reflects the income from its real estate venture, and that it is entitled to have the refund claim considered on that basis because the method of reporting the income used in its income tax return was erroneous.

The respondent contends that the method of reporting the income from real estate sales adopted

by the petitioner (A) was authorized by law, (B) was used in the petitioner's books and income tax return, (C) clearly reflects income, (D) was a binding election which prevents a change to the installment basis in the refund claim, and (E) cannot be changed to the installment basis without burdening and impeding administration of the revenues.

The fundamental error in the petitioner's contention is the failure to observe and apply the distinction between (a) a situation, as here, where the method of reporting income elected by the taxpayer clearly reflects income but in using this valid method a mistake in valuation of the sales contracts may have been made and (b) a situation not present herein which as a matter of law the method used is inapplicable.

In this case the method of reporting installment sales as deferred payment sales not on the installment plan is capable of clearly reflecting the petitioner's income even though the petitioner may have erroneously computed the *amount* of the fair market value of the sales contracts in using this method. In such a situation any overstatement of income must be corrected in accordance with the method adopted and not by a change of method. The taxpayer here has erroneously sought to change its method, but has not sought to correct an alleged overstatement of income by the usual and only proper procedure of an amended return and a timely refund claim and suit in accordance with its method of reporting income.

A. THE DEFERRED PAYMENT METHOD OF REPORTING INCOME FROM INSTALLMENT SALES IS AUTHORIZED BY THE STATUTE AND REGULATIONS

1. This method is authorized by the statute

Section 22 (a) of the Revenue Act of 1928 which defines gross income expressly provides that gross income includes gains, profits, and income derived from sales of real property. Section 22 (e) provides that the gain or loss on the sale of property shall be computed as provided in Sections 111, 112, and 113.

Section 111 (a) provides that the gain from the sale of property shall be the excess of the "amount realized" over the basis provided in Section 113. Section 111 (c) provides that the amount realized shall be the sum of any money received plus the fair market value of the property (other than money) received.

Articles 354 and 561 of Treasury Regulations 74 under the 1928 Act provide for the exceptional case in which the property or obligations of the vendee received by the vendor have no fair market value. In such a case the cash and any property with a fair market value which is received is applied to reduce the vendor's basis of the property sold and the excess, if any, is taxed. Gain or loss is realized when the obligations are disposed of or satisfied to the extent of the difference between the reduced basis and the amount realized. Cf. *Burnet* v. *Logan,* 283 U. S. 404.

These provisions of the statute and regulations provide a complete and accurate method for determination of gain or loss on the sale of real property. Further provisions for computation of taxable income from such sales were not necessary but Congress provided an alternative method of reporting income on the installment basis in some cases.

Sections 41 to 48, Title I of the 1928 Act, are designated "Part IV—Accounting Periods and Methods of Accounting," and contain the provisions with respect to the installment basis.

Section 41 (Appendix p. 44) provides in part:

> The net income shall be computed * * * in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income.

Section 44 (a) (Appendix p. 45) provides that a dealer in personal property on the installment plan may return as income therefrom in any taxable year

> that proportion of the installment payments actually received in that year which the gross profit realized or to be realized when payment is completed, bears to the total contract price.

Section 44 (b) provides that in the case (1) of a casual sale of personal property under stated conditions, or

> (2) of a sale or other disposition of real property, if in either case the initial payments do not exceed 40 per centum of the selling price, the income may, under regulations prescribed by the Commissioner with the approval of the Secretary, be returned on the basis and in the manner above prescribed in this section.

These provisions of the statute, apart from the treasury regulations, disclose two alternative methods of reporting income from installment sales. Section 111 provides the general method applicable to all sales. Section 44 provides an alternative and special method applicable to some sales.

2. This deferred payment method is authorized by the regulations

Treasury Regulations 74, Articles 352–354, (Appendix pp. 48–50), expressly authorized by Section 44, regulate the use of these two methods of reporting income from installment sales. Article 352 divides deferred payment sales of real property into (1) sales in which payments received during the taxable year in which the sale is made do not exceed 40% of the selling price, called sales on the installment plan, and (2) sales in which the payments do exceed 40% of the selling price, called deferred payment sales not on the installment plan.

Article 353, with respect to sales on the installment plan, provides that the vendor "may" return the income on the installment basis or:

> If the vendor chooses as a matter of consistent practice to return the income from installment sales on the straight accrual or cash receipts and disbursements basis, such a course is permissible, and the sales will be treated as deferred-payment sales not on the installment plan.

Article 354 provides in part that in deferred payment sales of real property not on the installment plan

> the obligations of the purchaser received by the vendor are to be considered as the equivalent of cash to the amount of their fair market value in ascertaining the profit or loss from the transaction. * * * If the obligations received by the vendor have no fair market value, the payments in cash or other property having a fair market value shall be applied against and reduce the basis of the property sold, and, if in excess of such basis, shall be taxable to the extent of the excess. Gain or loss is realized when the obligations are disposed of or satisfied, the amount being the difference between the reduced basis as provided above and the amount realized therefor. Only in rare and extraordinary cases does property have no fair market value.

3. Congress has approved the Regulations

The Treasury Regulations applying the two different statutory methods of reporting income on the sale of real estate on the installment basis have been approved by Congress (a) by the enactment of the 1926 Act and (b) by reenactment of the provisions of the 1926 Act in all of the later Revenue Acts.

a. Prior to Section 212 (d) of the Revenue Act of 1926, which contained provisions similar to Section 44 of the 1928 Act, the Revenue Acts did not expressly provide a method for computation of net income on the installment basis but the Commissioner's regulations permitted the use of this method.[2] *Burnet* v. *S. & L. Bldg. Corp.*, 288 U. S. 406, 413; cf. *McEachern* v. *Rose*, No. 6, this Term, 302 U. S. 56, 57 (preliminary print). Following the decision in *B. B. Todd, Inc.*, v. *Commissioner*, 1 B. T. A. 762, (decided March 16, 1925) to the effect that the statute (the Revenue Act of 1918 in that case) did not authorize the installment basis used in the regulations, the Revenue Act of 1926, Section 212 (d) adopted "the basic principles of the installment method authorized by prior regulations." *Burnet* v. *S. & L. Bldg. Corp.*, 288 U. S. 406, 413–414.

b. The provisions of the Revenue Acts and Regulations applying one of these two methods of re-

[2] Article 117, Treasury Regulations 33 (Revised Edition promulgated January 2, 1918); Articles 42–46, Regulations 45, 62, 65.

porting income from the sale of real property have been repeatedly reenacted in the later Revenue Acts and Treasury Regulations. This reenactment of the statutory provisions after the deferred method had been applied to the installment sales of real estate is an approval of this method. *Burnet* v. *S. & L. Bldg. Corp.*, 288 U. S. 406, 415.

B. THE DEFERRED PAYMENT METHOD WAS USED BY THE PETITIONER IN ITS BOOKS AND RETURN

The petitioner purchased the realty, known as the Culver City Park Tract, for $309,000 cash and $300,000 of its purchase money notes secured by a declaration of trust dated July 1, 1927 (R. 68–93), which created a so-called subdivision trust (R. 114), a security device (R. 29, 199–200) commonly used in the development and sale of a tract of land divided into residential lots. Cf. Treasury Regulations 74, Article 351. The property was conveyed to the trustee for the purposes of the trust (R. 44). The declaration of trust provided that the entire sales price of every lot and all interest on each contract of sale should be paid to the trustee and that all sums received by the trustee from the sale of lots should be used to pay the expenses and improvements of the property and the purchase money notes and any balance should be paid to the petitioner (R. 82–84).

The form of installment sales contract (R. 94–105) used in selling lots in 1928 (R. 44) provides that the trustee, as seller, agrees to sell and con-

vey the property and the buyer agrees to pay part of the purchase price upon execution of the agreement and the balance in monthly installments with 7 per cent interest (R. 94–95). The buyer agrees to pay to the seller all assessments against the property (R. 96). The contract provides that full performance by the buyer is a condition precedent to his right to a conveyance. Upon any default of any payment of principal or interest the seller may take possession of the premises and all payments made by the buyer and improvements on the land shall be retained by the seller as liquidated damages (R. 96–97).

The record does not disclose which lots or how many lots were sold for cash, or for a down payment of more than 40 per cent of the contract price, or for a down payment of less than 40 per cent which would have permitted use of the installment basis in the original return for such sales.[3]

1. The trustee kept books of the activities of the trust and allocated the cost of the tract and the expenses of improvements of the property to the separate lots. When a lot was sold the profit was determined by deducting from the selling price the cost of the lot, improvements, and commissions. From these data, obtained from the trustee, the petitioner made the entries on its records and books

[3] The record contains only the general statement of F. W. Shelton, secretary of the petitioner from 1926 to 1930, that "Most of the contracts were sold on the basis of 25 percent down and the balance over a period of time" (R. 108).

kept in the regular course of its business and disclosed the cost, expenses, sales price, and profit from the lots sold in 1928 (R. 108–114).

The petitioner's books disclosed a gross profit in 1928 from sales of the real estate in the sum of $306,181.69 and thus treated the sales contracts as equivalent to cash and used the deferred payment method of accounting not on the installment plan (R. 111). The petitioner did not calculate the income on the installment basis on its books.

2. The petitioner's return for 1928 (R. 128–139) disclosed income from the trust in the sum of $137,007.17 computed in accordance with the method of accounting employed in keeping the books of the petitioner by treating the sales as deferred payment sales not on the installment plan and by treating the obligations of the petitioner as having fair market value equivalent to their face value (R. 42–43).

C. THE DEFERRED PAYMENT METHOD CLEARLY REFLECTS THE PETITIONER'S INCOME

The deferred payment method clearly reflects income from installment sales by treating the obligations of the purchaser as cash to the amount of their fair market value in ascertaining profit or loss from the transaction. If they have no fair market value they are not included in computing the gain or loss and gain or loss attributable to them is realized when they are disposed of or satisfied. Regulations 74, Art. 354, Sec. 111 (c) of the 1928 Act.

If the purchaser defaults in any of his payments under either the deferred payment or installment method the profits previously reported as income are considered in computing gain or loss. Regulations 74, Articles 353–354. Similarly, if an installment obligation is satisfied at other than its face value or is sold or exchanged the computation of profit or loss is based on the amount of income which would be returnable if the obligation was satisfied in full and thus is based on the amount of profit or loss previously returned. Revenue Act of 1928, Section 44 (d), Regulations 74, Article 355.

It is plain that as a general matter the deferred payment method does "clearly reflect the income" (Section 41 of the 1928 Act) from installment sales. The respondent submits that this method clearly reflects income in the instant case.

Under the deferred payment method provided by the statute and regulations in force when the petitioner made its return for 1928, the fair market value of the sales contracts in the year of the sales might have been fixed at an amount less than their face value if the facts warranted such a computation. In such a case payments on the contracts in later years in excess of the estimated fair market value might have been returned as income when received. Indeed, as is pointed out *infra*, p. 35, a change *from* the installment *to* the deferred payment method has been permitted in certain cases where the obligations became valueless or

greatly decreased in value in the year of receipt. These cases indicate that in such circumstances the deferred payment method more accurately reflects income.

In using the deferred payment method the petitioner chose to consider the contracts as worth their face value. In such a case, if the buyer defaulted in a later year, or if the contract obligation was satisfied for less than its face value, the computation of the profit or loss in the later year would be based on the income reported in the year of sale (Regulations 74, Article 355).

Moreover, the petitioner never presented to the Commissioner the contention that the contracts did not have a fair market value equal to their face value and that, therefore, income on the deferred payment method should be recomputed and a refund should be allowed. The petitioner's books used face value of the contracts. The original return (R. 128–139) used face value of the contracts in reporting income. No amended return alleging, or setting forth proof of, a fair market value less than face value, was filed. The refund claim (R. 46–49) does not state that the face value was greater than fair market value but merely states that an error was made in reporting on a closed transaction or deferred payment basis instead of on the installment basis (R. 48).

In computing income on the installment basis the face value and not on the fair market value of the

buyer's contract obligations is used. In this action, the petitioner has relied wholly on the legal contention that the installment basis should be used and has not proved a fair market value of the sales contracts less than their face value which it might have attempted to do in an amended return, a timely refund claim, and a timely action on that ground.[4]

Furthermore, the amount of the difference between the face and fair market value of the contracts, if any, does not appear. There is no substantial competent evidence, finding of fact, or proposed finding by the petitioner on this question.

The only facts disclosing the possibility of a difference between face and fair market value of the contracts is the general statement of Elwell that the contracts had a face value of one-third to one-half of the sales price (R. 117–118) and the fact

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[4] The only evidence in the record on the question of fair market value of the sales contracts is the one general and somewhat ambiguous statement of the petitioner's witness, William H. Elwell, to the effect that the contract had a fair market value of from one-third to one-half of the selling prices, and that their fair market value when executed would be reduced by the cash payments (R. 117–118).

Although the witness testified that he was not interested in the outcome of the case (R. 118), it is apparent that he was interested in the question of value of the contracts because he was the sales agent who stated that he could not sell the lots for the prices obtained, and he had also maintained that they were not worth such prices (R. 115–118). He had at least the motive of supporting his business judgment in stating that fair market value was less than face value of contracts. He gave no detailed reasons for his opinion.

that some of the contracts involved "delinquent accounts" in 1928 (R. 143).[5]

Even though the sales prices might have been excessive in some cases the contracts may have had a fair market value approximately equal to face value. The buyers, unlike buyers of land for speculative purposes which are often financially irresponsible corporations organized for that purpose, were individuals, prospective subdivision homebuilders, and presumably financially responsible. The large cash down payment of 25 per cent. (R. 108) would tend to assure performance of the contracts even though the sales prices were somewhat excessive because the down payment would be lost by non-performance and thus even a new contract for another lot at a more reasonable price might eventually be no less expensive. The sales

[5] The petitioner's exhibits 9 and 10 (R. 143–144) are statements prepared by the petitioner's witness Kaplan from the books of the trustee which purport to set forth some slight information concerning "delinquent accounts." They do not show the extent of delinquency of the accounts. There is nothing to show that delinquent accounts were not later collected in full. These exhibits were admitted in evidence over the respondent's objections and exceptions on the ground that the books of account were the best evidence (R. 119–123). These exhibits, prepared by one who did not keep the books, were inadmissible when the books were not in evidence. *Cohan* v. *Commissioner*, 39 F. (2d) 540, 544 (C. C. A. 2nd). The petitioner's failure to produce or introduce the books in evidence raises the presumption that the evidence was unfavorable to it. *Chicago Railway Equipment Co.* v. *Commissioner*, 39 F. (2d) 378, 380 (C. C. A. 7th).

contract provided that title should not be conveyed until all payments were made and that 7 per cent. interest should be paid on all installments. The seller might repossess the land and keep the payments and improvements made or seek specific performance. Such a typical "seller's contract" for the sale of lots in a residential subdivision for permanent residence might be worth a fair market value equal or nearly equal to its face value even if the sales prices were excessive.

D. THE USE OF THE DEFERRED PAYMENT METHOD IS A BINDING ELECTION WHICH PREVENTED THE PETITIONER FROM CHANGING TO THE INSTALLMENT METHOD IN THE REFUND CLAIM

The petitioner's books and return filed on March 14, 1929, used the deferred payment method. Not until the refund claim (R. 46–49) was filed almost two years later on February 26, 1931, did the petitioner suggest that it wished to use the installment method by the statement in the refund claim that profits were erroneously reported as based on closed sales although the sales were made on the installment basis (R. 48). The respondent submits that a taxpayer cannot wait two years perhaps until offsetting deductions in later years are determined, and then in a refund claim attempt to change its method of accounting for profits and losses in order to report income in a different manner and amount and in different years in order to obtain a smaller tax and a refund.

1. The statute requires an election

The statute contemplates that the taxpayer shall elect one method of accounting. Section 44 (b) states that a taxpayer who makes an installment sale of realty *may* use the installment method. Section 44 (c) states that if a taxpayer *elects* to report income on the installment basis amounts received in the taxable year on sales in prior years shall not be excluded.

Similarly the rule of a binding election by the taxpayer is recognized in other sections of the Revenue Act of 1928. Section 51 provides for single returns or joint returns by a husband and wife living together and the choice made is a binding election. *Morris* v. *Commissioner* 40 F. (2d) 504 (C. C. A. 2d); Sections 52, 141, and 142 provide for separate or consolidated returns of affiliated corporations and the choice made is a binding election. *Lucas* v. *St. Louis National Baseball Club,* 42 F. (2d) 984 (C. C. A. 8th), certiorari denied 282 U. S. 883. Section 56 (b) and (e) provides that a taxpayer "may elect to pay the tax" in four installments or even in advance "at the election of the taxpayer." Section 101 provides for the tax on capital net gain "at the election of the taxpayer." Section 131 (d) provides that a taxpayer has the option or election to take the credit for foreign taxes in the year accrued irrespective of his method of accounting.

It is apparent that the rule of a binding election must be observed in order to avoid the confusion in

the administration of the revenue laws which would result if a taxpayer might change his method of accounting if subsequent events disclose a smaller tax would result. It is submitted that Congress intended that the taxpayer's choice of the deferred payment or installment method of accounting should constitute an election, and, like the other statutory elections under the Act, should be binding.

2. The election is binding

Choice of the deferred payment or installment method has been held to be an election prohibiting a change to the other method. *Livermore* v. *Miller,* decided January 26, 1938, by the Fifth Circuit Court of Appeals, Prentice-Hall Federal Tax Service, 1938, vol. 1, paragraph 5.177; *Commissioner* v. *Moore,* 48 F. (2d) 526, 528 (C. C. A. 10th); *Ambridge* v. *Heiner,* 17 Am. Fed. Tax. Rep. 1022 (W. D. Pa., not officially reported); *Sylvia S. Strauss* v. *Commissioner,* 33 B. T. A. 855, affirmed *per curiam,* 87 F. (2d) 1018 (C. C. A. 2d); *Johnson Realty Trust* v. *Commissioner,* 21 B. T. A. 1333; *Morgan Rundel* v. *Commissioner,* 21 B. T. A. 1019; *Gilbert W. Lee* v. *Commissioner,* 6 B. T. A. 135. Cf. *Garber* v. *Commissioner,* 50 F. (2d) 588 (C. C. A. 9th); *Viault* v. *Commissioner,* 36 B. T. A. 430; *Briarly* v. *Commissioner,* 29 B. T. A. 256; *Derbes* v. *Commissioner,* 24 B. T. A. 276, affirmed 69 F. (2d) 788 (C. C. A. 5th); *Mrs. H. C. Walker, Jr.* v. *Commissioner,* 23 B. T. A. 1, affirmed 63 F.

(2d) 346 (C. C. A. 5th); *James C. Ellis* v. *Commissioner*, 16 B. T. A. 1225.

In *Gilbert W. Lee* v. *Commissioner, supra,* the evidence showed that the taxpayer's returns were upon the installment basis in effect and in refusing to permit a change to the straight cash receipts basis the Board stated at page 138:

> Having once made his election, the petitioner should not be allowed to change to a different basis merely because subsequent legislation or other events made it to his interest so to do.

In *Morgan Rundel* v. *Commissioner, supra,* the Board refused to allow a change from the installment basis and stated the rule at page 1020:

> Subsequent events or a change of mind now make petitioner's choice of the installment basis not to his liking, and so he seeks another method which it is claimed will produce a lower tax.
>
> It has been held, however, in a number of cases that the filing of a return of income according to one of two alternative methods recognized by statute constitutes a binding election and the taxpayer may not thereafter report on another basis. * * *

The rule requiring the taxpayer to elect in the original return the method of reporting income operates also in the closely analogous situations of single or joint returns by husband and wife (*United States* v. *Pettigrew,* 81 F. (2d) 666

(C. C. A. 9th); *Anderson* v. *United States,* 48 F. (2d) 201 (C. C. A. 5th); *Morris* v. *Commissioner,* 40 F. (2d) 504 (C. C. A. 2d); *Rose* v. *Grant,* 39 F. (2d) 340 (C. C. A. 5th); *Buttolph* v. *Commissioner,* 29 F. (2d) 695 (C. C. A. 7th), and of consolidated or separate returns by affiliated corporations *Safety Electric Products Co.* v. *Helvering,* 70 F. (2d) 439 (C. C. A. 9th); *Dr. Pepper Bottling Co.* v. *Commissioner,* 69 F. (2d) 768 (C. C. A. 5th); *Radiant Glass Co.* v. *Burnet,* 54 F. (2d) 718 (App. D. C.); *Lucas* v. *St. Louis National Baseball Club,* 42 F. (2d) 984 (C. C. A. 8th), certiorari denied, 282 U. S. 883. The election once made is binding.

The doctrine of election has been continuously utilized in the revenue acts and enforced by the courts. The authorities cited above disclose that its operation is necessary in the administration of collection and refund of the revenues. Like the statutes of limitations upon assessment and collection, refund claims, and suits to recover taxes, application of the doctrine of election is an equitable means of realizing to some degree the public policy of repose and termination of tax litigation.

3. Congress has approved the rule requiring a binding election

The statutory provisions of the 1926 and 1928 Acts with respect to reporting income from installment sales, interpreted by the cases cited above to require a binding election, have been reenacted in all the later revenue acts. This reenactment is a

legislative approval of the rule of election. In *Burnet* v. *S. & L. Bldg. Corp.*, 288 U. S. 406, 415, the Court stated that the Board of Tax Appeals had consistently upheld the regulations in respect of profits on installment sales and then the Court remarked that the later revenue acts substantially reenacted the pertinent provision of the 1926 Act.

4. The present case should be distinguished from situations in which a method adopted is not applicable to the taxpayer under the terms of the statute or does not clearly reflect income

The present situation of a binding election of one of two applicable methods of reporting income from installment sales, both of which clearly reflect the petitioner's income, must be distinguished from situations (involved in some of the decisions relied on by the petitioner) of an erroneous use of a method of accounting which is not applicable to a taxpayer under the terms of the statute or which does not clearly reflect income.

If the taxpayer, under the 1928 Act, attempts to use the installment basis for sales in which the down payment is more than 40% of the sales price, a binding election may not occur because the statute does not permit taxation of income on such sales on the installment basis. In such a case the error may be corrected and income computed on the deferred payment basis. *Biscayne Bay Islands Co.* v. *Commissioner*, 23 B. T. A. 731, 735; *Georgia-Florida Co.* v. *Commissioner*, 16 B. T. A.

1253, 1259. The instant case is distinguishable because the petitioner is attempting to change from deferred payment method which is applicable to it under the statute.

Cases relied on by petitioners, such as *Key Largo Shores Properties, Inc.*, v. *Commissioner*, 21 B. T. A. 1008, and *Ives Dairy, Inc.*, v. *Commissioner*, 23 B. T. A. 579, affirmed 65 F. (2d) 135 (C. C. A. 5th), are clearly distinguishable because, although they hold that the use of a method of accounting not legally applicable to the taxpayer may not be an election, they recognize that choice of one of two legal methods applicable to the taxpayer, as in this case, is a binding election.

In the *Key Largo* case the taxpayer reported on the installment basis an income of $64,887.67 from the sale of a tract of Florida land in 1925. The Commissioner refused to accept a computation in an amended return filed in 1927 on the deferred payment basis which disclosed no profit and an uncollected cost of $7,000. The Board held that the basis for the rule of election, the use of a method which correctly reflected income, did not exist because before the close of the year 1925 it was clear that the purchase money second mortgage, included in the contract price in the computation of income on the installment basis, was valueless and the corporate purchaser financially irresponsible. Excluding the second mortgage the Board held that the transaction was in effect the

sale of land, purchased for $36,610 in cash and a first mortgage of $53,250, for the price of $82,860 in cash and an assumption of the mortgage and therefore the installment method did not apply. If the second mortgage is excluded it will be noted, although the Board did not expressly so state, that the installment method was not applicable under the statute because the cash payment of $36,610 was more than 25% of the sale price.

The Board distinguished the *Key Largo* case from *Morrow, Becker & Ewing, Inc.* v. *Commissioner,* 21 B. T. A. 1013, reversed 57 F. (2d) 1 (C. C. A. 5th), and *Morgan Rundel* v. *Commissioner,* 21 B. T. A. 1019, where, as here, the method of reporting income chosen by the taxpayer was within the terms of the statute and did clearly reflect income and, therefore, was a binding election. These three cases decided by the Board on the same day arose out of the collapse of the Florida land boom in 1925.

In the *Morrow* case, *supra,* the facts found by the Board (21 B. T. A. 1013, 1014–1017) disclose that the taxpayer on March 15, 1926, made a return on the installment basis of its profits of $342,869.17 from its sales of real estate in 1925, whether the initial payment was more or less than one-fourth of the sales price. The Commissioner segregated the sales and treated those in which the initial payments did not exceed one-fourth of the sale price as installment sales and the balance as de-

ferred payment sales in which the obligations of the purchasers were treated as equal to the cost of the land to the taxpayer. This increased taxpayer's income by $16,333.77. In December 1926, the taxpayer filed an amended return for 1925, in which it computed the profits by the deferred payment method and showed a loss of $20,874.07.

The Board (21 B. T. A. 1013, 1017) distinguished the *Key Largo* case on the ground that in that case the taxpayer had parted with title for the purchase money second mortgage shown to be valueless within the taxable year, but here, as in the instant case, the taxpayer retained title under the sales contracts and thus on default retained its capital in the form of land and also the cash contract payments. Moreover, the taxpayer made collections of $247,858.96 on the contracts in the following year. The Board held that under the circumstances it could not be said that the taxpayer's income had been distorted to its disadvantage by the installment basis and, therefore, the installment method could not be changed.

The Fifth Circuit Court of Appeals stated that the Board's findings that the contracts had no fair market value and that the value of the land was decreasing in 1925 were inconsistent with its opinion affirming the determination of the Commissioner. The Court also stated that Section 212 (d) of the 1926 Act, adopted shortly before the return was filed, and the regulations under the 1926 Act

adopted shortly thereafter, made substantial changes in the existing law as to the basis for determining profits on installment sales and that therefore the Commissioner abused his discretion in not accepting the amended return.

That case may be distinguished from the present case because it is based upon an alleged abuse of discretion by the Board in failing to accept an amended return in a situation in which, in the court's view, the law was changed at the time the first return was filed. No abuse of discretion by the Commissioner is involved here, because the tax year involved is 1928, and the practice was long settled and the taxpayer did not even attempt to file an amended return, but sought to change from the deferred payment to the installment basis for the first time in his refund claim.

The court did not mention the doctrine of election, and did not deny that election may operate in this type of case. Indeed, in later cases the same court upheld the application of the doctrine of election in cases involving installment sales. *Walker* v. *Commissioner,* 63 F. (2d) 346, 349, *Livermore* v. *Miller,* Prentice-Hall Federal Tax Service, 1938, Vol. 1, paragraph 5.177.

If the court's view that the important question in the case was whether the purchaser's obligations had any fair market value is correct, the present case is also distinguishable because the only evidence on that question in the present case was that

the purchasers' contract obligations have a substantial fair market value (R. 117–118).

Moreover, it is submitted that the decision of the Circuit Court of Appeals in the *Morrow* case is erroneous. The view of the court that substantial changes in reporting installment sales were made after or at about the time the return was filed is not correct. Section 212 (d) of the Revenue Act of 1926 and the regulations adopted pursuant to that Act adopted the installment method authorized by the prior regulations, Regulations 65, Articles 42–46, of the 1924 Act, under which the taxpayer filed its return on the installment basis. The taxpayer must be charged with knowledge of these detailed regulations in force when it filed its return, and the supposed lack of such knowledge suggested by the court supplied no basis for the statement that the Board abused its discretion.

Moreover, this decision in failing to recognize the doctrine of election is inconsistent with the later decisions of the same court in *Walker* v. *Commissioner,* 63 F. (2d) 346, 349, and *Livermore* v. *Miller, supra,* in which the doctrine is enforced.

In *Kaplan* v. *United States,* 18 F. Supp. 965 (C. Cl.) No. 667, this Term, Government's petition for certiorari granted February 14, 1938, and the case set down for argument immediately after this case, the petitioner reported profits from the installment sale of stock in 1929 by the deferred payment method, and after default of payments on the

contract in 1931, sought to change to the installment basis for the first time in a refund claim filed on March 12, 1932. The Court of Claims without citing any of the prior decisions on election discussed above, held that the statute and regulations did not require a binding election.

Insofar as the decision in the *Kaplan* case is based on the court's view that the deferred payment method did not correctly reflect income, the decision is distinguishable because the deferred payment method clearly reflects income in the present case. The Court of Claims in an earlier opinion, *LeBolt & Co.* v. *United States,* 67 C. Cls. 422, 426, recognized this distinction between a case, as here, in which there is a binding choice between two legal and proper methods of returning income, and a case of an erroneous return if there is only legal and proper method of making a return. Cf. *Pathe Exchange* v. *Commissioner,* 77 F. (2d) 306 (C. C. A. 2nd); *Continental Bank & Trust Co.* v. *United States,* 19 F. Supp. 15, 20 (S. D. N. Y.).

Furthermore, the Government contends in its brief in the *Kaplan* case that the decision is wrong because the deferred payment method clearly reflected the income and an election is binding.

In *Ives Dairy Inc.* v. *Commissioner,* 23 B. T. A. 579, affirmed 65 F. (2d) 135 (C. C. A. 5th), the Board followed the *Key Largo* case, *supra,* and permitted a taxpayer to change to the deferred payment basis, although it had reported on the

installment basis a sale of real estate in Florida in 1925 for a price of $60,000 paid in cash and purchased purchase money notes for $177,325, which the Board found had a fair market value of not less than $20,000 during 1925. The Board stated that (p. 584) "Under ordinary circumstances such a change is not permitted," but determined that the case justified application of the rule of the *Key Largo* case where the purchaser's obligations became worthless during the taxable year. The taxpayer petitioned for review and urged that the notes had no fair market value but the Fifth Circuit Court of Appeals affirmed the Board on the ground there was evidence to support the value of $20,000. There is no evidence in the present case to show that the purchaser's obligations were worthless during the taxable year or that in the taxable year a discrepancy so great as in the *Ives* case between face and fair market value could be determined.

Moreover, both the *Key Largo* and *Ives* cases, permitting a change from the installment to the deferred payment method on the ground that the installment method does not clearly reflect income when the purchaser's obligations are determined to be worthless in the taxable year, suggest that where the purchaser's obligations are not worth their face value the deferred payment method more clearly reflects income. Such decisions are no authority for permitting a change from the deferred

payment method to the installment method where, as here, the method originally adopted clearly reflects income.

No extenuating circumstances exist here which would have required the Commissioner to exercise discretion to relieve petitioner from its election even if it had requested such relief. The petitioner's secretary made the return and testified that most of the contracts were sold for 25 per cent. down (R. 108). Even under the 1926 Act and regulations long in force, profit from such contracts could be returned on the installment basis. The taxpayer cannot be excused by a general assertion of lack of knowledge that the installment method was available. Cf. *Moran* v. *Commissioner*, 67 F. (2d) 602 (C. C. A. 1st), *Buttolph* v. *Commissioner*, 29 F. (2d) 695 (C. C. A. 7th).

Moreover, no extenuating circumstances were promptly presented to the Commissioner for administrative relief by an amended return. The excuse comes too late to be heard when it is first presented in testimony on the trial of the refund action.

E. ADMINISTRATION OF THE REVENUES WOULD BE MATERIALLY IMPEDED BY ANY GENERAL RULE ALLOWING TAXPAYERS TO CHANGE FROM ONE METHOD TO ANOTHER IN REPORTING INSTALLMENT SALES

Any general rule of law permitting taxpayers, within the time for filing refund claims, to change the method adopted for reporting income from installment sales for prior years if later events dis-

close that the shift of the taxable gain from one year to another will produce a lower tax, adds an unnecessary complication impeding administration of the revenues.

The underlying basis of the doctrine of election of judicial remedies generally has been stated to be "the maxim which forbids that one shall be twice vexed for one and the same cause." *United States v. Oregon Lumber Co.*, 260 U. S. 290, 301. The important practical consideration of great administrative inconvenience if the choice of method of reporting income from installment sales is not a binding election supplies a substantial and important reason which makes the doctrine of election particularly applicable to the present situation.

The statute and regulations disclose clearly and expressly that a taxpayer may report income from certain installment sales by one of two methods. The application of the doctrine of election is equitable in such circumstances and fairly helps to achieve the desirable policy that tax liability be determined promptly.

II

THE PETITIONER CANNOT NOW HAVE THE INCOME INVOLVED TAXED AS THE INCOME OF A TRUST

The petitioner in point II of its brief (pp. 26–32) raises a new question by the contention that, apart from the question of the use of the installment or deferred payment method, the income from the real estate venture is taxable to it only

to the extent of its distributable share determined by considering the subdivision trust as a strict trust taxable under Section 143–161 of the Revenue Act of 1928.

This new question was not raised or considered in the courts below. The petition for a writ of certiorari did not present it. The brief in opposition does not suggest it. "Review by this Court will be limited accordingly." *Zellerbach Co.* v. *Helvering,* 293 U. S. 172, 182.

The respondent contends that this new point was not presented either in a timely refund claim or in this action in the trial court or the court below and, therefore, there is no jurisdiction to grant a refund on this new ground. Moreover, the new contention is invalid on the merits.

The tax was paid in four installments in 1929 (R. 24). The first and timely refund claim (R. 46–49) filed on February 15, 1931, did not rely on this ground or any related ground. The "amended claim" (R. 50–53) filed on April 4, 1932, after the expiration of the two year period for filing refund claims allowed by Section 322 (b) (1) of the 1928 Act, set forth the additional ground that the trust was an association taxable as a corporation within Section 701 (a) (2) of the 1928 Act. The "amended claim" did not mention the ground now presented.

The amended complaint (R. 4–10) alleged that the trust was an association taxable as a corpora-

tion but did not refer to the new ground now advanced. The trial court made a conclusion of law that the "amended claim" was an amendment not barred by limitations (R. 30) and that the trust was not an association taxable as a corporation (R. 29) but did not refer to the new ground.

The trustee's fiduciary return (R. 149–153), the petitioner's proposed conclusion of law numbered III (R. 175), not adopted by the trial court, and assignments of error numbered 12 and 13 (R. 184–185), might possibly suggest the new ground, although the contention was not more expressly raised or considered by the court below in its opinion.

A. THERE IS NO JURISDICTION TO ALLOW RECOVERY ON THE NEW GROUND, NOT PRESENTED IN A TIMELY REFUND CLAIM OR IN THE PLEADINGS OR TRIAL BELOW

1. This new ground was not presented in either the timely claim or the late "amended claim." A refund claim is a jurisdictional prerequisite to suit and no suit can be maintained in the absence of a refund claim based on the ground asserted in the suit. *United States* v. *Felt & Tarrant Co.*, 283 U. S. 269, 272; *United States* v. *Memphis Cotton Oil Co.*, 288 U. S. 62, 66; T. D. 4265 in effect on May 1, 1929, and adopted pursuant to R. S. Sec. 3226 as amended by Sec. 1113 (a) of the 1926 Act.

2. Even if this new ground had been presented in a late claim before the timely claim was rejected it would have been barred because it is not related

to the first and only timely claim. *United States* v. *Garbutt Oil Co.* No. 262, this Term. *United States* v. *Andrews,* No. 48, this Term, both decided January 4, 1938. The new ground is not presented in the late "amended claim." The new ground and the ground presented in that claim, whether the trust was an association taxable as a corporation, are not related. The "amended claim" did not suggest or require, or in fact procure, an administrative consideration of the new ground. The theories of recovery are different. But even if the new ground were considered to be included in the "amended claim" in some manner that would not aid petitioner because the "amended claim" was not related to the timely claim and was a barred claim. *United States* v. *Garbutt Oil Co., supra, United States* v. *Andrews.*

3. Apart from the lack of a refund claim and even if there had been a timely claim on the new ground there can be no recovery on this ground because it was not pleaded in the complaint. Even an amendment now after expiration of the period of limitations for suits to recover refunds, in order to add this new ground would be unavailing. *United States* v. *Seminole Nation,* 299 U. S. 417; *Lorenzen* v. *United States,* 52 F. (2d) 106 (C. C. A. 8th).

B. APART FROM THE JURISDICTIONAL QUESTION THE INCOME INVOLVED IS TAXABLE TO THE PETITIONER AND NOT TO THE TRUSTEE

Apart from the jurisdictional question which bars any recovery on the new contention, the respondent submits that the contention is without merit because the trust involved is a mere security device and not a trust taxable under Section 161 of the 1928 Act.

The trust here involved was not an active trust conducted by the trustee but was merely the well-known security device known as a "sub-division trust" and commonly used to finance the subdivision and sale of a tract of land in residential lots. Cf. *Lewis & Co.* v. *Commissioner,* 301 U. S. 385. In this case the trustee was merely the agent of the petitioner with the duty of applying part of the profits from the sales of real estate to the payment purchase money notes of the petitioner. In such a situation the gross profits from the sales apply to payment of the petitioner's obligations, are its income and taxable to it. Cf. *Pugh* v. *Commissioner,* 17 B. T. A. 429, 436, affirmed on other issues, 49 F. (2d) 76 (C. C. A. 5th), certiorari denied, 284 U. S. 642; *Cleveland Trust Co.* v. *Commissioner,* 24 B. T. A. 132; *Munger* v. *Commissioner,* 16 B. T. A. 168; *Boynton* v. *Commissioner,* 11 B. T. A. 1352; G. C. M. 2185, VI–2, Cumulative Bulletin p. 75; G. C. M. 4120, VII–2, Cumulative Bulletin p. 108.

Moreover, the record is wholly insufficient to determine the basis upon which the income might be taxed as income of a trust. It is submitted that this new contention is not presented by this case and also that on the merits the income is taxable to the petitioner.

CONCLUSION

The judgment of the court below should be affirmed.

Respectfully submitted.

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FEBRUARY 1938.

APPENDIX

Revenue Act of 1926, c. 27, 44 Stat. 9:

NET INCOME OF INDIVIDUALS DEFINED

SEC. 212. (d) Under regulations prescribed by the Commissioner with the approval of the Secretary, a person who regularly sells or otherwise disposes of personal property on the installment plan may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the total profit realized or to be realized when the payment is completed, bears to the total contract price. In the case (1) of a casual sale or other casual disposition of personal property for a price exceeding $1,000, or (2) of a sale or other disposition of real property, if in either case the initial payments do not exceed one-fourth of the purchase price, the income may, under regulations prescribed by the Commissioner with the approval of the Secretary, be returned on the basis and in the manner above prescribed in this subdivision. As used in this subdivision the term "initial payments" means the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable period in which the sale or other disposition is made.

INSTALLMENT SALES

SEC. 1208. The provisions of subdivision (d) of section 212 shall be retroactively applied in computing income under the provi-

sions of the Revenue Act of 1916, the Revenue Act of 1917, the Revenue Act of 1918, the Revenue Act of 1921, or the Revenue Act of 1924, or any of such Acts as amended. Any tax that has been paid under such Acts prior to the enactment of this Act, if in excess of the tax imposed by such Acts as retroactively modified by this section, shall, subject to the statutory period of limitations properly applicable thereto, be credited or refunded to the taxpayer as provided in section 284.

Revenue Act of 1928, c. 852, 45 Stat. 791:

PART II—COMPUTATION OF NET INCOME

SEC. 21. NET INCOME.

"Net income" means the gross income computed under section 22, less the deductions allowed by section 23.

SEC. 22. GROSS INCOME.

(a) *General definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

* * * * *

(e) *Determination of gain or loss.*—In the case of a sale or other disposition of property, the gain or loss shall be computed as provided in sections 111, 112, and 113.

PART IV—ACCOUNTING PERIODS AND METHODS OF ACCOUNTING

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 48 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year.

SEC. 42. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period.

SEC. 43. PERIOD FOR WHICH DEDUCTIONS AND CREDITS TAKEN.

The deductions and credits provided for in this title shall be taken for the taxable

year in which "paid or accrued" or "paid or incurred," dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period.

SEC. 44. INSTALLMENT BASIS.

(a) *Dealers in personal property.*—Under regulations prescribed by the Commissioner with the approval of the Secretary, a person who regularly sells or otherwise disposes of personal property on the installment plan may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the gross profit realized or to be realized when payment is completed, bears to the total contract price.

(b) *Sales of realty and casual sales of personalty.*—In the case (1) of a casual sale or other casual disposition of personal property (other than property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year), for a price exceeding $1,000, or (2) of a sale or other disposition of real property, if in either case the initial payments do not exceed 40 per centum of the selling price, the income may, under regulations prescribed by the Commissioner with the approval of the Secretary, be returned on the basis and in the manner above prescribed in this section. As used in this section the term "initial payments" means the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable period in which the sale or other disposition is made.

(c) *Change from accrual to installment basis.*—If a taxpayer entitled to the benefits of subsection (a) elects for any taxable year to report his net income on the installment basis, then in computing his income for the year of change or any subsequent year, amounts actually received during any such year on account of sales or other dispositions of property made in any prior year shall not be excluded.

SUPPLEMENT B—COMPUTATION OF NET INCOME

SEC. 111. DETERMINATION OF AMOUNT OF GAIN OR LOSS.

(a) *Computation of gain or loss.*—Except as hereinafter provided in this section, the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the basis provided in section 113, and the loss shall be the excess of such basis over the amount realized.

* * * * *

(c) *Amount realized.*—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

(d) *Recognition of gain or loss.*—In the case of a sale or exchange, the extent to which the gain or loss determined under this section shall be recognized for the purposes of this title, shall be determined under the provisions of section 112.

(e) *Installment sales.*—Nothing in this section shall be construed to prevent (in the case of property sold under contract providing for payment in installments) the taxation of that portion of any installment payment representing gain or profit in the year in which such payment is received.

SEC. 112. RECOGNITION OF GAIN OF LOSS.

(a) *General rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

SEC. 113. BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Property acquired after February 28, 1913.*—The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; except that—

* * * * *

Treasury Regulations 74:

ART. 321. *Computation of net income.*—Net income must be computed with respect to a fixed period. Usually that period is 12 months and is known as the taxable year. Items of income and of expenditures which as gross income and deductions are elements in the computation of net income need not be in the form of cash. It is sufficient that such items, if otherwise properly included in the computation, can be valued in terms of money. The time as of which any item of gross income or any deduction is to be accounted for must be determined in the light of the fundamental rule that the computation shall be made in such a manner as clearly reflects the taxpayer's income. If the method of accounting regularly employed by him in keeping his books clearly reflects his income, it is to be followed with respect to the time as of which items of gross income and deductions are to be accounted for. (See articles 331–333.) If the taxpayer does not regularly employ a method of accounting which clearly reflects

his income, the computation shall be made in such manner as in the opinion of the Commissioner clearly reflects it.

ART. 322. *Bases of computation.*—Approved standard methods of accounting will ordinarily be regarded as clearly reflecting income. A method of accounting will not, however, be regarded as clearly reflecting income unless all items of gross income and all deductions are treated with reasonable consistency. See section 48 for definitions of "paid or accrued" and "paid or incurred." All items of gross income shall be included in the gross income for the taxable year in which they are received by the taxpayer, and deductions taken accordingly, unless in order clearly to reflect income such amounts are to be properly accounted for as of a different period. * * *

ART. 331. *When included in gross income.*—Gains, profits, and income are to be included in the gross income for the taxable year in which they are received by the taxpayer, unless they are included as of a different period in accordance with the approved method of accounting followed by him. * * *

ART. 352. *Sale of real property involving deferred payments.* Under section 44 deferred-payment sales of real property fall into two classes when considered with respect to the terms of sale, as follows:

(1) Sales of property on the installment plan, that is, sales in which the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable year in which the sale is made do not exceed 40 percent of the selling price.

(2) Deferred-payment sales not on the installment plan, that is, sales in which the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable year in which the sale is made exceed 40 percent of the selling price.

Sales falling within class (1) and class (2) alike include (a) agreements of purchase and sale which contemplate that a conveyance is not to be made at the outset, but only after all or a substantial portion of the selling price has been paid, and (b) sales where there is an immediate transfer of title, the vendor being protected by a mortgage or other lien as to deferred payments.

In the sale of mortgaged property the amount of the mortgage, whether the property is merely taken subject to the mortgage or whether the mortgage is assumed by the purchaser, shall be included as a part of the "selling price," but the amount of the mortgage, to the extent it does not exceed the basis to the vendor of the property sold, shall not be considered as a part of the "initial payments" or of the "total contract price," as those terms are used in section 44, in articles 351 and 353, and in this article. Commissions and other selling expenses paid or incurred by the vendor are not to be deducted or taken into account in determining the amount of the "initial payments," the "total contract price," or the "selling price."

ART. 353. *Sale of real property on installment plan.*—In transactions included in class (1) in article 352 the vendor may return as income from such transactions in any taxable year that proportion of the installment payments actually received in that year

which the total profit realized or to be realized when the property is paid for bears to the total contract price.

* * * * *

If the vendor chooses as a matter of consistent practice to return the income from installment sales on the straight accrual or cash receipts and disbursements basis, such a course is permissible, and the sales will be treated as deferred-payment sales not on the installment plan.

ART. 354. *Deferred-payment sale of real property not on installment plan.*—In transactions included in class (2) in article 352, the obligations of the purchaser received by the vendor are to be considered as the equivalent of cash to the amount of their fair market value in ascertaining the profit or loss from the transaction.

If the vendor had retained title to the property and the purchaser defaults in any of his payments, and the vendor repossesses the property by agreement or process of law, the difference between (1) the entire amount of the payments actually received on the contract and retained by the vendor and (2) the sum of the profits previously returned as income in connection therewith and an amount representing proper adjustment for exhaustion, wear and tear, obsolescence, amortization, and depletion of the property while in the hands of the purchaser, will constitute gain or loss, as the case may be, to the vendor for the year in which the property is repossessed, and the basis of the property in the hands of the vendor will be the original basis at the time of the sale. If the vendor had previously transferred title to the purchaser, and the purchaser defaults in any of his payments

and the vendor reacquires the property, such repossession shall be regarded as a transfer by the vendor, in exchange for the property, of such of the purchaser's obligations as are applied by the vendor to the purchase or bid price of the property. Such an exchange will be regarded as having resulted in the realization by the vendor of gain or loss, as the case may be, for the year of repossession, measured by the difference between the fair market value of the property and the basis in the hands of the vendor of the obligations of the purchaser (generally, the fair market value thereof which was previously recognized in computing income) which were applied by the vendor to the purchase or bid price of the property. The fair market value of the property shall be presumed to be the amount for which it is bid in by the vendor in the absence of clear and convincing proof to the contrary. If the property so acquired is subsequently sold, the basis for determining gain or loss is the fair market value of the property at the date of acquisition.

If the obligations received by the vendor have no fair market value, the payments in cash or other property having a fair market value shall be applied against and reduce the basis of the property sold, and, if in excess of such basis, shall be taxable to the extent of the excess. Gain or loss is realized when the obligations are disposed of or satisfied, the amount being the difference between the reduced basis as provided above and the amount realized therefor. Only in rare and extraordinary cases does property have no fair market value.

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SUPREME COURT OF THE UNITED STATES.

No. 528.—October Term, 1937.

Pacific National Company, Petitioner,
vs.
Galen H. Welch, Former Collector of Internal Revenue for the Sixth District of California.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit.

[May 2, 1938.]

Mr. Justice Butler delivered the opinion of the Court.

March 14, 1929, petitioner filed its income tax return for 1928. The return reported $137,007.17 as profit resulting from sales of lots in that year. That figure was arrived at by adding to the cash paid in 1928, on account of the sales, the amounts later to be paid, and by deducting from the total the cost of lots and improvements and expenses of the sales.

In 1931 petitioner filed a claim for refund of the entire tax on the ground that the sales had been made on the installment basis, but the profits had been reported as if the sales were for cash, and that this was erroneous. The claim was rejected. Petitioner sued; trial by jury having been waived, the district court made findings of fact and held that petitioner reported income as authorized by the Revenue Act of 1928 and applicable regulations, and thereby made an election which became binding on the expiration of the time allowed for filing the return. Accordingly it gave judgment for respondent. Upon the same ground the circuit court of appeals affirmed. 91 F. (2d) 590. The decision below being in conflict with that of the Court of Claims in *Kaplan* v. *United States*, 18 F. Supp. 965, we granted a writ of certiorari. — U. S. —.

Under the applicable statutes and regulations, petitioner could have chosen either of two methods for the ascertainment and report of gain or loss on the sales. The Revenue Act of 1928, 45 Stat. 791, establishes both. Defining one, the "deferred payment method", it declares that gross income includes profits from sales, § 22(a); regulates the computation of gain or loss, § 22(e); defines gain to be the excess of the amount realized over the basis, §§ 111(a),

113; and provides that the "amount realized" shall be the sum of any money received plus the fair market value of property (other than money) received, § 111(c). Regulations 74, Art. 352. Defining the other, the "installment method", it provides that, in the case of a casual sale or other casual disposition of personal property for a price exceeding $1000 or in the case of sale or other disposition of real property, if payments received during the taxable year in which the sale was made do not exceed 40 per cent of the selling price, the income may, under regulations prescribed, be returned on the installment method (§ 44(b)); i. e., the taxpayer may return in any taxable year that proportion of the installment payments actually received in that year which the gross profit realized or to be realized when payment is completed bears to total contract price. See § 44(a).

Regulations 74 permit the vendor to return income from installment sales on the straight accrual or cash receipts basis; when so reported the sales are treated as deferred payment sales not on the installment plan. Art. 353. In ascertaining the amount of profit or loss from that class of sales, the obligations of the purchaser to the vendor are taken at their fair market value; if they have none, the payments in cash or other property having a fair market value shall be applied against and reduce the basis of the property sold, and if in excess of such basis, shall be taxable to the extent of the excess. Gain or loss is realized when the obligations are disposed of or satisfied, the amount being the difference between the reduced basis and the amount realized therefor. Art. 354.

The question is whether, having filed a return according to the deferred payment method, the taxpayer by filing claim for refund is entitled to have the profit from the sales computed on the installment method.

Petitioner contends that the installment method alone discloses its income from the sales of lots and that the deferred payment method failed clearly to reflect income.

Conceding that its return might have been made in accordance with either method, petitioner says that, being ignorant of both, it treated the sales as if made for cash at figures mentioned in the contracts. Its argument, therefore, rests upon the assertion, which we assume to be true, that the promises of purchasers to pay installments were worth less than face value. But that fact has no bearing upon the question whether proper application of the deferred payment method would clearly reflect income, for that

method permits installments to be taken at market value and, if they have no market value, allows postponement of ascertainment of gain or loss until realized. While petitioner's return may have been an inept application of the deferred payment method, there is nothing in it or the statement of claim for refund that gives any support to the idea that, if rightly applied, that method would not clearly reflect income.

The parties agree that, if allowed to change to the installment method, petitioner would be entitled to a refund in some amount. But that fact has no tendency to discredit the deferred payment method as inapplicable. The amount of the tax for the year in question is only one of many considerations that may be taken into account by the taxpayer when deciding which method to employ. The one that will produce a higher tax may be preferable because of probable effect on amount of taxes in later years. In case of overstatement and overpayment, the taxpayer may obtain refund calculated according to the method on which the return was made. Change from one method to the other, as petitioner seeks, would require recomputation and readjustment of tax liability for subsequent years and impose burdensome uncertainties upon the administration of the revenue laws. It would operate to enlarge the statutory period for filing returns (§ 53(a)) to include the period allowed for recovering overpayments (§ 322(b)). There is nothing to suggest that Congress intended to permit a taxpayer, after expiration of the time within which return is to be made, to have his tax liability computed and settled according to the other method. By reporting income from the sales in question according to the deferred payment method, petitioner made an election that is binding upon ~~him~~ it and the commissioner.*

Affirmed.

Mr. Justice CARDOZO and Mr. Justice REED took no part in the consideration or decision of this case.

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* Commissioner *v.* Moore, 48 F. (2d) 526, 528, certiorari denied 284 U. S. 620. Marks *v.* United States, 18 F. Supp. 911, 913. Sylvia S. Strauss, 33 B. T. A. 855, affirmed 87 F. (2d) 1018. Max Viault, 36 B. T. A. 430, 431. Sarah Briarly, 29 B. T. A. 256, 258. Louis Werner Saw Mill Co., 26 B. T. A. 141, 144-145. Liberty Realty Corporation, 26 B. T. A. 1119. Morgan Rundel, 21 B. T. A. 1019. Johnson Realty Trust, 21 B. T. A. 1333. Cf. United States *v.* Pettigrew, 81 F (2d) 666; Rose *v.* Grant, 39 F. (2d) 340; Alameda Inv. Co. *v.* McLaughlin, 33 F. (2d) 120; Buttolph *v.* Commissioner, 29 F. (2d) 695; Safety Electric Products Co. *v.* Helvering, 70 F. (2d) 439; Dr. Pepper Bottling Co. *v.* Commissioner, 69 F. (2d) 768; Radiant Glass Co. *v.* Burnet, 54 F. (2d) 718.